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Welcome to Moscow



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Print edition July 4th 2009

Welcome to Moscow
Paranoid, mischievous and heading in the wrong direction, Russia is an awkward prospect for Barack Obama: leader



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Politics this week

Jul 2nd 2009
From The Economist print edition

AFP



There was a military coup in **Honduras** after Manuel Zelaya, the leftist president, tried to organise an unconstitutional referendum to allow him to stand for a second term. He was arrested and deported by the army, which acted with the support of Congress and the Supreme Court. The head of Congress was sworn in as president, pending an election in November. The Organisation of American States, the United States and the European Union all condemned the coup and called for Mr Zelaya's reinstatement. See article

Argentina's first couple, President Cristina Fernández and her husband and predecessor, Néstor Kirchner, fared badly in a mid-term legislative election, losing their majority in Congress. Several centrist leaders did well in a repudiation of the Kirchners' populist economic policies. Mr Kirchner resigned as leader of the ruling Peronist movement. Once the election was over, authorities in several provinces declared health emergencies as deaths from swine flu rose to 35. See article

In **Nicaragua**, Alexis Arguello, a former world-champion boxer, was found dead at his home. He was the victorious candidate of the ruling Sandinista Party in an election for mayor of Managua last year that the opposition claimed was fraudulent.

Not a surprise

Iran's Guardian Council declared that Mahmoud Ahmadinejad had been re-elected as president, dismissing claims of ballot-rigging. Mr Ahmadinejad said his victory was a defeat for Western foes seeking to overthrow the Islamic system, but opponents insisted his win was illegitimate. Opposition protests were attended by fewer people. Security forces rounded up hundreds of opposition figures. Nine locally hired members of the British embassy were detained, though later most were freed. See article

A Yemenia airliner with 153 people on board crashed into the sea as it came in to land at Moroni, the capital of the **Comoros**. There was one survivor, a 14-year-old girl.

American troops completed their withdrawal from cities in **Iraq**, despite a recent rise in suicide-bombings. The Iraqi government announced a holiday to mark "National Sovereignty Day", and said its forces would be able to maintain security. Barack Obama said the pull-back was a milestone but warned of "difficult days" ahead.

A strike of the sword

Around 4,000 American marines, backed by NATO aircraft, launched a big offensive against the Taliban in **Afghanistan's** southern Helmand river valley.

AFP



The high court in Delhi ruled that consensual **gay sex in India** was not a crime, overturning a 19th-century law that bans what it terms sex "against the order of nature". Gay sex was previously punishable by up to ten years in prison. A few days before the decision the second-ever gay-pride march was held in the capital.

North Korea test-fired more short-range missiles, ratcheting up tensions in the region and defying recently tightened UN sanctions. Meanwhile, **South Korea's** defence minister said that the North is "definitely" trying to enrich uranium, giving it another method to make nuclear bombs. The South claims the North has 40 kilograms of plutonium, enough for at least six bombs.

China delayed a plan requiring all new computers in the country to be equipped with internet-filtering software. Web users claimed this as a victory, though an official said it would only be "a matter of time" before the filtering system was introduced.

Malaysia's prime minister, Najib Razak, relaxed some of his country's racial-preference laws in an effort to encourage foreign investment. He said listed companies would no longer have to sell at least 30% of their shares to ethnic Malays. However, listed firms will have to sell 25% to the Malaysian public, of which half will be reserved for ethnic Malays. Mr Najib's main rival, Anwar Ibrahim, has promised more sweeping reforms to the laws. See article

Squaring a circle

Germany's constitutional court ruled that the European Union's Lisbon treaty is compatible with German law, but only if the German parliament passes a new law to make clear that it participates fully in EU legislation. The court seems to think the EU has a "democratic deficit" that is best filled at the national level, not through the European Parliament.

Albania's election was too close to call. The centre-right coalition of the prime minister, Sali Berisha, got 70 seats, as did the centre-left opposition led by Edi Rama. There may be another election this autumn. See article

The prime minister of **Croatia**, Ivo Sanader, unexpectedly stepped down, saying he wanted to give up politics. Croatia's hopes of joining the EU have been stymied by a border dispute with neighbouring Slovenia.

Russia put into force a ban on casinos and gambling joints across most of the nation. They are now allowed only in parts of the country that are a long way from Moscow.

Reverse discrimination

AP



America's **Supreme Court** ruled that New Haven, Connecticut, was wrong to deny promotion to white firemen because no blacks had scored high enough marks in a qualifying exam to warrant advancement. The case attracted a lot of interest, not least because one of the judges on the appeals-court panel that saw its previous decision in the lawsuit overturned was Sonia Sotomayor, Barack Obama's nominee to the top court. See article

The House voted narrowly, by 219 to 212, in favour of a climate-change bill that establishes a **cap-and-trade** system to reduce emissions. The legislation is not without its critics (44 Democrats voted against it) and it is expected to receive a rough ride in the Senate. See article

After almost eight months of argument and litigation, **Minnesota's** Supreme Court decided that Al Franken had won the state's Senate race for the Democrats, by 312 votes. The result gives the Democrats 60 votes in the Senate, enough to break a filibuster. See article

Gallup reported that the **drinking habits** of Americans haven't changed during the recession, with 64% enjoying the occasional tipple. There has been anecdotal evidence that drinking has increased during the downturn. Beer remains the favoured libation, though the percentage of wine-drinkers has increased since Mr Obama took office.

Business this week

Jul 2nd 2009
From The Economist print edition

Bernard Madoff was sentenced by a judge in Manhattan to 150 years in prison, the maximum term allowed, for operating a $65 billion Ponzi scheme. He had pleaded guilty to possibly the biggest fraud in history. For many years Mr Madoff, a former chairman of the NASDAQ stockmarket, assured his clients that their money was safe with him. He did not receive a single letter of support at his sentencing hearing. See article

A judge in Houston decided that **Sir Allen Stanford** should remain in jail until the start of his trial for allegedly swindling investors. Prosecutors said there was a significant chance he might abscond if granted bail. The tycoon and former cricket impresario has a passport issued by Antigua, where the banking operations at the centre of the case are based.

Rio grand

Rio Tinto completed its $15.2 billion rights issue, the fifth-biggest on record. **Chinalco**, China's state aluminium firm, took part, maintaining its 9% holding in the mining company. Chinalco had been on course to invest $20 billion in Rio. Heavily indebted Rio chose instead to raise money by selling new shares and combining its iron-ore operations in Australia with BHP Billiton. This led the official Chinese media to dub Rio a "dishonourable woman".

Porsche's request for a €1.75 billion ($2.5 billion) loan from a state-controlled bank in Germany was turned down. The carmaker is now looking at "alternative financing possibilities", which may include an investment from the state of Qatar. Porsche ran up €9 billion in debt when it accumulated a stake in **Volkswagen** in an abortive takeover. Hammering out a merger has become increasingly acrimonious as the controlling Porsche and Piëch families try to determine who will ultimately be in charge.

The **Bank for International Settlements**, which serves as a bank for central banks, said that more needed to be done to repair the balance-sheets of big financial companies. It urged governments to shift their priorities from stimulus packages for their economies towards mending the financial system, and to "persevere until the job is done".

The European Union's competition commissioner raised the possibility of breaking up Britain's biggest banks. Neelie Kroes said that the enormous public aid given to companies such as **Lloyds Banking Group** and **Royal Bank of Scotland** gave them an advantage in certain markets and that under EU rules "the likelihood of significant divestments by RBS and Lloyds is strong".

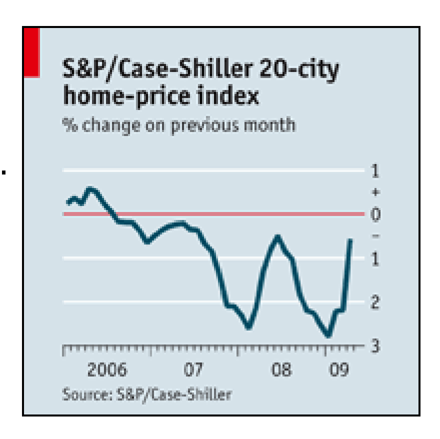
Three **green groups** in Britain brought a lawsuit against the Treasury to force the department to ensure that bailed-out banks comply with government policy on investing in "sustainable and ethical" projects. The groups are targeting RBS, which once styled itself as "the oil and gas bank" because of its importance as a lender to the energy industry. The lawsuit highlights the potential vulnerability of state-aided banks to political pressures.

Towers Perrin and **Watson Wyatt** agreed to merge in a deal valued at $3.5 billion. The human-resources consultancy groups provide advice to employers on staff benefits, such as health-insurance claims, and executive pay.

Some positive negative news

The S&P/Case-Shiller index of **house prices** in 20 American cities fell again in April, but at a more modest rate. Several cities saw prices rise. Dallas notched up the biggest monthly increase of 1.7%. See article

Manufacturing output in America in June shrank at its slowest pace for ten months, according to the Institute for Supply Management. Its index rose to 44.8; below 50 indicates that manufacturing is contracting. In Japan, industrial output jumped by 5.9% in May compared with April, though manufacturers produced nearly 30% less than they did a year ago.



Mozilla launched the latest version of its **Firefox** internet browser, which claims to download web pages twice as fast as the previous incarnation. Competition has increased among internet browsers; Microsoft has updated its Internet Explorer and Apple released a new version of its Safari browser. New features are being rolled out that enable applications to run from servers rather than being stored on computer hard drives.

“Off The Wall” through the roof

High street and online retailers reported that sales of **Michael Jackson’s** albums and songs surged after his death from an apparent heart attack on June 25th. Amazon sold more of the pop star’s recordings in the 24 hours following his demise than it had in the whole of the past decade. Demand from Jackson devotees was apparently greater than that of Elvis Presley and John Lennon fans after their deaths.

KAL's cartoon

Jul 2nd 2009
From The Economist print edition

Illustration by KAL



America and Russia

Welcome to Moscow

Jul 2nd 2009
From The Economist print edition

Paranoid, mischievous and heading in the wrong direction, Russia is an awkward prospect for Barack Obama

Getty Images



THE last time Barack Obama was in Russia, he and Senator Dick Lugar were detained by border guards for several hours at an airport in the Urals, where they were looking at how American funds were helping to get rid of stocks of dangerous Soviet-era weapons. America's president has every reason to hope things will go better this time, but that is not setting a very high hurdle for success. Of all the great power relationships Mr Obama inherited from George Bush, Russia is the most awkward—awkward not only because it has been getting ever harder to deal with but also because it cannot be ignored.

Over the past ten years, under Vladimir Putin's leadership, Russia has become more nationalistic, corrupt and corporatist. Its economy, although much bigger than a decade ago, is even more dependent on oil and gas, an industry now controlled by a small group of kleptocratic courtiers and former spies. The decision by Ikea, a well-known Swedish furniture supplier once bullish about Russia, to suspend investment because of graft is an indictment of the dire commercial climate (see article). Its non-energy exports are smaller than Sweden's.

Russia's population is shrinking alarmingly, its death rate double that in most developed countries. Conflicts in its north Caucasus republics have flared again. Its armed forces are woefully ill-equipped and poorly trained. Mr Putin has kept control by unleashing a virulent brand of anti-Western "patriotism"—the latest textbooks are as tough on America as they are soft on Stalin—and thuggishly silencing the opposition. Last year in a pretence of democracy Mr Putin installed Dmitry Medvedev (Mr Obama's supposed host) as president while he himself became prime minister.

In the long term Mr Putin's refusal to modernise his country will weaken Russia. Yet the place Mr Obama has to deal with now is still a potent force. The largest country on earth, Russia stretches from Europe to China. It is the world's biggest producer of oil and gas. It has a seat on the UN Security Council and of course that nuclear arsenal. Above all it has the capacity to do both great harm and some good (see article).

Vlad the invader

Recently, the harm has been more noticeable. Last year's invasion of Georgia, followed by Russia's

decision to recognise South Ossetia and Abkhazia, was the clearest sign that Mr Putin has given up any hope of joining the West. Since then he has slammed the door on the World Trade Organisation, opting instead for a no-doubt-mighty customs union with Belarus and Kazakhstan. Russia has long criticised the Organisation for Security and Co-operation in Europe for daring to highlight election malpractice. Now Mr Medvedev is promoting a European security structure that would in effect give Russia a veto over any expansion of NATO. Countries such as Ukraine, in what Russia regards as its sphere of influence, are nervous. At the UN Russia has dragged its feet on sanctions against Iran and autocrats pretty much everywhere.

And yet Iran is also one of many examples of how Russian and American interests should coincide. Neither Mr Obama nor Mr Putin wants to see Iran emerge as a nuclear power, setting off a destabilising arms race in the Middle East. Both also want a stable Afghanistan, with al-Qaeda pushed out of sanctuaries there and in Pakistan: Russia has been a useful conduit for Western supplies and troops. Both have worked to safeguard nuclear and other weapons materials in the old Soviet Union and are co-operating usefully in other countries.

On not being a pushover

Mr Bush's policy towards Russia was both confused and confusing. One moment he was looking into Mr Putin's eyes and finding a man he could trust; the next he was preaching democracy while failing to lift cold-war economic restrictions. Mostly, though, he was not very interested in Russia—and it showed. Russia, self-esteem wounded, claimed that America was promoting democracy to further its geopolitical interests.

Mr Obama's combination of calmness and humility could well help America deal with a country whose national pride is dangerously spiked with a sense of inferiority. But there are plenty of pitfalls ahead.

America's president needs to resist the temptation to play on supposed differences between Mr Putin and the more "liberal" Mr Medvedev. These are more notional than real, as the farcical second show trial of Mikhail Khodorkovsky, a former oil boss and a Putin rival, which is taking place on Mr Medvedev's watch, demonstrates.

Meanwhile, humility about some of America's past mistakes should not leave Russia's leaders with the impression that Mr Obama will be a pushover. Robustness is necessary because of the widening gap between the interests of the Russian people and those of its ruling elite (the people who stoke anti-Americanism even as they send their offspring to Western universities and buy up holiday homes in France). With the economy declining and social discontent rising, a stand-off with the West might be tempting for Mr Putin's cabal—but ruinous for most Russians. It was not America's fault that Russia failed to develop an independent judiciary, opting for corruption as the organising principle of its political system. Nor is it America's fault that Russia wasted the years of high oil prices.

Most of all, Mr Obama needs to be firm over Russia's ambitions to dominate the countries along its western and southern borders. Mr Bush's attempt to hurry Georgia and Ukraine into NATO, ready or not (they weren't, and won't be for a long time) was a mistake. But both countries, like all others in Europe, have the right to choose their own friends. Mr Obama must make clear that he will not cut them adrift and will not tolerate attempts to destabilise their governments. Europeans could help too by diversifying their oil and gas supplies so that Russia is not tempted to turn off their taps either (see article).

Ironically, given Mr Obama's difficulties in the Urals, the easiest place to start may be arms control. There is room to reduce further both sides' warheads; it is also a subject that flatters Russia. But this is going to be an awkward relationship, one where the West's expectations of success should be low.

The coup in Honduras

Lousy president, terrible precedent

Jul 2nd 2009
From The Economist print edition

Manuel Zelaya should be restored to power. He should also be forced to respect the constitution

AFP



IT WAS a flashback to a nightmare that Latin Americans hoped they had awoken from for good. Heavily armed soldiers burst into the presidential residence in Tegucigalpa, the capital of Honduras, in the early hours, arrested the pyjama-clad president, Manuel Zelaya, and bundled him off to neighbouring Costa Rica. Once all too familiar, such events have become rare in Latin America over the past two decades as democracy has put down roots. It was the first coup in the region since the confused ousting of Jean-Bertrand Aristide in Haiti in 2003, and a brief rising against Venezuela's Hugo Chávez in 2002.

In Honduras the soldiers acted with the support of the courts and the legislature, whose head, Roberto Micheletti, was sworn in as president to serve out the remainder of Mr Zelaya's term until January next year (see page 43). Even so, as Barack Obama rightly said, the ousting of Mr Zelaya was "illegal" and set "a terrible precedent". It was universally and emphatically condemned in Latin America. It is vital for democracy in the region that it should be reversed.

But to stop there is to miss some of what is at stake. Mr Zelaya, a businessman, alienated his own party and his country's political establishment by his decision last year to forge an alliance with Mr Chávez, joining the Venezuelan's anti-American block. In return, he got aid and political advice. Mr Zelaya felt emboldened to organise a referendum on convening a constituent assembly—the very device Mr Chávez used to establish an autocracy. Since such an exercise violated the constitution and both Congress and the courts were firmly opposed to it, this unleashed a conflict of powers.

Oddly, the Honduran constitution contains no provision for impeachment. Even so, kicking Mr Zelaya out was wholly the wrong way to try to resolve the dispute. It was stupid, too: Mr Zelaya was fairly unpopular and unlikely to get his way. That it happened regardless shows the deep fear of Mr Chávez among political establishments across Latin America. He is a particular ogre in the small, mainly poor and unstable countries of Central America, which are also beset by drug traffickers. Venezuela's boss is mistrusted both for his meddling and for the example he has set of coming to power democratically and then stacking the rules in his favour. One of his allies, Daniel Ortega of Nicaragua, next-door to Honduras, stole a municipal election last November, for instance.

For change, stick to the electoral road

Yet fear is turning to paranoia. If many left-of-centre governments, of varying political hues, have come

to power in Latin America it is because voters became fed up with their right-of-centre predecessors. Some are now starting to tire of leftist and populist incumbents too. This week Argentines served notice on the Kirchner family that their dominance is over (see article). Would-be election riggers in the region will find it hard to prevent the alternation that is the essence of democracy.

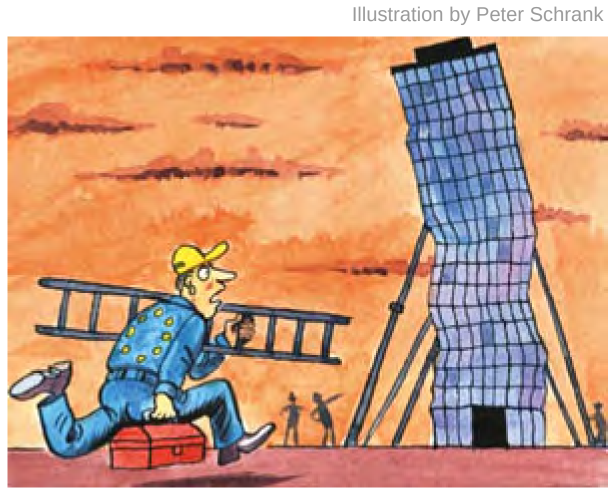
Honduras's new government finds itself friendless beyond its borders. Restoring Mr Zelaya to office should not be impossible. It will require economic pressure but also some kind of deal with Mr Micheletti's regime, perhaps involving an early election. Honduras's neighbours should help in this respect, as should the United States, which has considerable influence in Honduras and a strong interest in a stable, democratic Central America. By his forthright condemnation of the coup Mr Obama has ensured that he will not be outflanked by Mr Chávez over Honduras. The more difficult question for Latin America is how to prevent over-mighty presidents from undermining their own democratic institutions. Once that practice ceases, coups really will be a thing of the past.

Neither one thing nor the other

Jul 2nd 2009
From The Economist print edition

Wrongheaded rules for hedge funds and private equity, and an irrelevant plan for banks

Illustration by Peter Schrank



MORE Europe or less Europe: that was the choice set out by Adair Turner, the chairman of Britain's Financial Services Authority, in a discussion of financial reform in March. On the evidence since then, less is just fine. The European Commission has been busy enough, drafting proposals to regulate hedge funds and private-equity firms and to overhaul the continent's system of supervising cross-border financial institutions (see article). But Europe's ability to distract itself from the substantive issues far outweighs its capacity to resolve them.

Take that draft directive on hedge funds and private equity, a ragbag of measures requiring more disclosure, greater controls over leverage and tighter restrictions on non-EU funds. Some of these ideas make sense: more disclosure will help regulators to monitor the systemic risks that may be building outside the banks. But the poorly drafted proposal lumps different types of manager together. Controls on liquidity make much more sense for hedge funds than they do for private equity, for instance; the reverse could be argued for leverage limits.

And why on earth is the EU concentrating its fire on hedge funds and private-equity firms anyway? Some behaved irresponsibly during the boom times, to be sure, and many have been caught up in the bust. But they were not the cause of the crisis. Long-standing hostility to alternative investments on the part of the French and Germans is a better explanation for the desire to regulate them; the enfeebled status of Britain, the industry's main defender in the EU, for why that has translated into action now. Most of the signs are that the rules are not quite bad enough to drive fund managers out of the EU; but they are still a step backwards—a piece of shoddy financial politicking. The more sensible Swedes, who took over the EU's rotating presidency on July 1st, should bin most of them.

Continental Europeans would be better off worrying less about hedge funds in London and more about the state of their own banks. Spain unveiled a bank-rescue fund of up to €99 billion ($139 billion) on June 26th. Germany is finalising a plan to house its banks' colossal hoard of toxic assets.

Here the EU has identified a genuine problem—the system for supervising cross-border banks. But the result is a fudge. The failure of the Icelandic banks in the autumn highlighted the dangers to host countries of relying on the quality of foreign banks' home regulators; the dismemberment of Fortis into its constituent parts reminded everyone that national governments are likely to be on the hook if trouble strikes. Hence Lord Turner's stark choice: either national governments take a stronger role, forcing banks that operate on their territory to set aside money to pay for deposit schemes and other buffers, or cross-border supervision becomes more assertive.

The EU's response is a trio of supranational committees that will have the power to step in when domestic regulators disagree. It will also create a systemic-risk board to watch for the build-up of financial risk. But under pressure from Britain and others it has explicitly ruled out any infringements of fiscal sovereignty—ordering a government to prop up a bank, say.

Governments have shown that they can act together in a crisis. But if Europe cannot formally agree in advance on how to share the burden of bank bail-outs, the chances that supervisors of global banks will do so are close to zero. Cross-border banks look increasingly likely to be structured as bundles of smaller local entities that hold pools of capital and liquidity within national borders. Banks wanting to operate across borders may have to pay a price in reduced efficiency.

Brussels spouts

Indeed, the crisis has reinforced the importance of decision-makers below and above Europe on the international ladder. Below it, national regulators are best placed to monitor financial institutions; and national taxpayers are the ones who stump up when finance fails. Above it, global standard-setters such as the Basel Committee, which is drawing up new rules on bank capital and liquidity, are the best defence against the threat of jurisdiction-shopping by large financial institutions.

The good news is that there is striking consistency in the messages that these national and international regulators are sending out. From this week's annual report of the Bank for International Settlements to Barack Obama's reform blueprint in America, from the Bank of England's new financial stability report to the stern pronouncements of the Swiss central bank, there is a repeated and welcome emphasis on higher capital requirements, particularly in good times, on tougher rules on liquidity, and on special regimes for systemically important institutions. The EU may fiddle; the real chance of meaningful reform to the financial system lies elsewhere.

Education in America and Britain

Learning lessons from private schools

Jul 2nd 2009
From The Economist print edition

The right and wrong ways to get more poor youngsters into the world's great universities

Illustration by M. Jeeves



LOTS of rich people and crummy state schools, especially in the big cities where well-off folk tend to live: these common features of America and Britain help explain the prominence in both countries of an elite tier of private schools. Mostly old, some with fat endowments, places like Eton, Harrow and Phillips Exeter have done extraordinarily well. Fees at independent schools have doubled in real terms over the past 25 years and waiting lists have lengthened. Even in the recession, they are proving surprisingly resilient (see article). A few parents are pulling out, but most are soldiering on and plenty more are clamouring to get their children in.

Row, row together

All sorts of class-based conspiracy theories exist to explain the success of such institutions, but the main reason why they thrive in a more meritocratic world is something much more pragmatic: their ability to get people into elite universities. For Britain and America also have the world's best universities. Look at any of the global rankings and not only do the Ivy League and Oxbridge monopolise the top of the tree, British and (especially) American colleges dominate most of the leading 100 places. This summer graduates will struggle to find jobs, so a degree from a world-famous name like Berkeley or the London School of Economics will be even more valuable than usual. The main asset of the private schools is their reputation for getting children into those good universities.

Only 7% of British children go to private schools, but they account for more than 40% of the intake at Oxford and Cambridge. That statistic is a little unfair: private schools account for a fifth of the people taking A-levels (pretty much essential for getting in). All the same it is notable that Britain's two best-known universities educate more Etonians than boys who were poor enough to get free meals at their schools. In America figures are harder to come by, but the independent sector again does disproportionately well. The universities on both sides of the Atlantic have tried to balance things up (indeed, some rich British children are whisked out of private schools in their final years so they appear to have been state-educated). But in general the elite schools deserve their reputation for getting children onto the next rung up, if only because their pupils do so much better at the exams you need to pass to get in.

A system of elite schools and universities to which the rich have privileged access is neither fair nor efficient. Yet there are worse ways of organising education. At least Britain and America have top-class

universities: European and Asian countries, which don't, are scrambling to create some of their own. And attempts to increase equality by getting rid of elitism sometimes achieve the opposite: when British governments in the 1960s and 1970s abolished elite state grammar schools, it became harder still for poor, clever children to get into elite universities.

Nowadays few reformers talk about banning independent schools. Instead they look at fiddling with university admissions. Sadly the methods of most left-leaning educators say much more about their own outdated preoccupations than about the problem. In America tragically the focus has been on race and affirmative-action programmes—a system the private schools have duly exploited by giving scholarships to poor black and Hispanic pupils. In Britain the obsession has been class, with Labour ministers telling the dons of Oxford to find more working-class talent, and setting up a government "Office for Fair Access" (widely known as OffToff) to set targets, albeit non-binding ones, for the proportion of state-school applicants at each university.

There are some areas where universities could be reined in—notably America's system of favouring the children of alumni. But admissions are a symptom, not a cause. Black Americans and working-class Britons struggle because they are overwhelmingly educated in poor government-run schools. Change them and you change the system. And here the private elite schools are useful exemplars. Their success is not based on money, but on organisation. Make head teachers at state schools as accountable to parents as their peers at private schools are and give them the same freedoms, notably to sack poor teachers and pay more to good ones. Then people will not need to go to Winchester or Amherst any more.



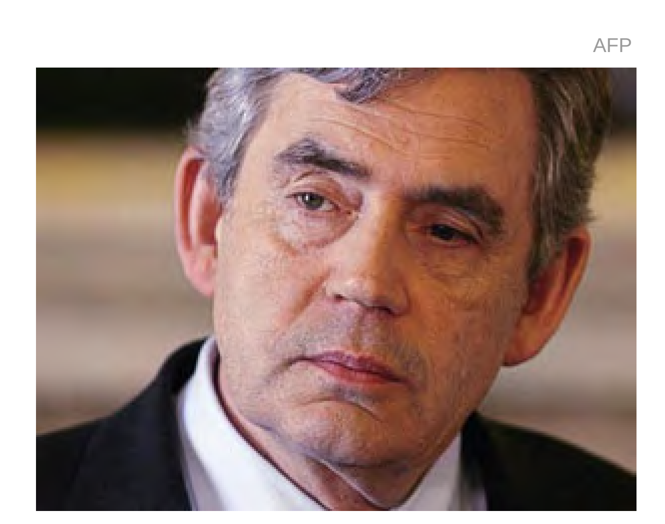

The relaunch of Gordon Brown

The vision thing

Jul 2nd 2009
From The Economist print edition

The prime minister's Big Idea for Britain is a day late and a dollar short

AFP



IN OCTOBER 2007 Gordon Brown decided against a snap election, ostensibly in order to lay his vision for Britain before the electorate in a more leisurely manner. Several bank bail-outs and one economic crisis later, the vision has landed. With its wan echo of New Labour reforming themes, the grab-bag of policies the prime minister portentously entitled "Building Britain's Future" is not up to much (see article). Far worse, in letting it be understood at the same time that there may not be a comprehensive spending review—a detailed analysis of future spending by department—in the coming year, Mr Brown has ducked the policy debate that really does matter: how to begin putting Britain's fiscal house in order.

Over the past few weeks, with troublesome elections for local government and the European Parliament out of the way, Britain's main parties have been squaring up for the next general election, which must be held by June 2010. The dividing lines are being sharply drawn.

Mr Brown says that the government is intent on keeping the money flowing in an effort to beat recession and create jobs. He maintains that the Conservatives would slash spending, lay waste to services and look unmoved on lengthening dole queues. For their part, the Tories in effect accuse Mr Brown of deception—of ignoring his government's own figures, which suggest departmental spending must be cut in real terms.

Mr Brown has one piece of history in his favour: unlike the stimulus-opposing Tories he was right to increase public spending in an attempt to soften and shorten the economic recession. But this argument is about the future. The time has come to set out in detail what must be done to restore the public finances as soon as recession ebbs. Britain is likely to borrow an amount equal to more than 12% of GDP in this financial year—unprecedented territory for a peacetime government. Debt is set to rise to perhaps 90% of GDP next year, on figures from the OECD, a rich-country think-tank. Yet Mr Brown has given only the vaguest prescriptions, involving that valiant warhorse "efficiency savings", for correcting matters in future.

Even if there is a brisk economic recovery soon (and this is no more than a hope) the gaping hole in the public finances will persist. The cost of servicing rising debt will rise. Spending on the unemployed will keep going up, as jobs do not begin to recover until after the economy as a whole does. Bank bail-outs must be accounted for at some point. So must all the off-balance-sheet spending the Labour government has gone in for, including billions in privately built and run public services, and the pensions paid to an ageing population will increase. Influential outsiders have already begun to point the finger at the vertiginous deterioration in Britain's public finances. Standard & Poor's, a credit-rating agency, voiced concern in May. So did the OECD this week (see article).

The best policy

The last thing any politician wants to do is to spell out the sacrifices he plans to impose on voters. The Tories have been more honest than Labour only in pointing out that something must give. (The Liberal Democrats, Britain's third party, are, commendably, a touch more detailed.) Mr Brown had a chance this week to show true leadership in putting forward a vision for Britain that included some hard choices. Instead it was a cosmetic exercise, rebranding public-service "standards" as ponderously enforceable "entitlements". Voters are not fools. They know that debts have to be repaid, and that the going will be tough for quite a while.

As a former chancellor of the exchequer, Mr Brown is well placed to try to sort out Britain's fiscal mess. The trouble is that, as former chancellor, he is responsible for much of it. In rearranging the policy deck chairs, he has sought to secure not Britain's future but his own. Perversely, this lets his Tory opponent avoid tough choices too: if Mr Brown insists current spending can and should go merrily up, David Cameron need only attack him for evasiveness to score points. If this is the sort of debate that can be expected, Britain's voters will be singularly ill-served in the run-up to the next election.



On schooling, Christina Romer, ethics, Brazil, Cambodia, Chevron, asylum seekers, pay, verbs

Jul 2nd 2009
From The Economist print edition

The lazy days of summer

SIR – Before Lexington disparages American children for their comparatively short school day he should take a closer look at the arguments (June 13th). First of all, international education surveys regularly compare the children of the elite in the developing world, such as China and India, with the mass of children in developed countries. We should compare like with like before moving to generalisations. Second, children in the upper socioeconomic classes in America regularly attend extra-curricular activities—art, sport, extra maths—that extend their day. This way I get to tailor my children's education rather than have them sit bored in a classroom for up to nine hours.

Third, rote learning does not equal intelligence and memorisation does not equal learning. Finally, studies show that grades and SAT scores are not always a predictor of career success.

My experience is that mass testing is replacing creative learning with worksheets, even as young as pre-school (kindergarten). Yet the skills required for this century will not be based in rote- and test-based-learning but in creative thinking. This is America's comparative advantage (look at Bill Gates). Maybe we have it right after all.

Jodi Detjen
Newton, Massachusetts

America's economy

* SIR – Christina Romer's comparison of the present economic situation to the 1930s was excellent, except for the glaring omission of the automatic economic stabilisers that exist today, such as unemployment insurance, food stamps, etc (Economics focus, June 20th). These programmes weren't around in the 1930s. But now they are causing government spending to increase hugely, which makes the $787 billion stimulus package largely unnecessary.

Dennis Fulmer
Canton, Ohio

* SIR – Ms Romer's parallels with 1937 should have mentioned the fact that America was a net exporter of oil products, led the world in steel production, dominated global automobile technology and production, and was a creditor nation. Perhaps the best lesson of 1937 is that historical parallels are generally specious.

Gene Cesari
South Ryegate, Vermont

Business ethics

SIR – We read your article on the efforts by Harvard's MBA students to develop a Hippocratic oath for managers ("Forswearing greed", June 6th). Although you are right to point out the differences between management and medicine, this does not prevent managers from adopting professional values. In many ways, professions define and sustain themselves with a collective agreement to be bound by regulations. So there is no reason why managers and business graduates should not sign up to a code of conduct.

The benefits are that, with time and enforcement, businesspeople will be held in higher regard and will be

able to refer to the code when asked or tempted to do something that they believe not to be in the best interests of their company. In the early days of modern medicine some people may have thought it "naive" to ask physicians to put the interests of their patients before their own. This is now expected practice.

Michael Moneypenny
Helen O'Sullivan
Centre for Excellence in Developing Professionalism
University of Liverpool
Liverpool

* SIR – Medical ethics is certainly a more developed discipline than business ethics. Nevertheless, one of the primary motivations for medicine's ethical code is the asymmetry of information that exists between doctor and patient. It is the inability of the patient to assess the medical practitioner's actions accurately that makes a strong ethical commitment on the part of the doctor essential to the success of the relationship.

This is analogous to relationships between managers and shareholders. There is a long way to go until we have a settled approach to business ethics, and the end result will undoubtedly be specific to business and not be a simple reworking of the Hippocratic oath.

However, it is not naive to work towards such a goal. What is naive is the thoughtless repeating of the same clichés that have traditionally held back progress in a discipline that is now more relevant to businesspeople than ever.

James Dempsey
Stirling

Down to earth

SIR – As a farmer and journalist who has followed the development of agriculture in Brazil for the past 50 years, I think you missed a very important point in your briefing on deforestation in the Amazon: the vast improvement in conservation methods ("The future of the forest", June 13th). This is partly explained by better education, but also because these methods have been applied in a "no till" system, known as *plantio direto* in Brazil. This plants seeds directly in the refuse of former crops, protecting the land from erosion, creating organic matter and building soil in the process. Proof lies in the fact that production on soyabean farms is increasing.

Farmers using these methods are a stabilising element as they set down roots rather than destroy the land and move on. Communities have been established where soil conservation is essential to progress. What is now needed is legislation to enable property rights and to assure that sensible forestry laws make it possible to achieve a decent living. This may require something that simply does not exist in Brazil: a forestry-police department with rangers who are trained, well paid and equipped to get where they need to go.

Ellen Bromfield
São Paulo

Cambodia's sex industry

SIR – Your article on the sex industry in Cambodia shed light on the problem of identifying sex-trafficking victims among female prostitutes ("The traffic police", June 13th). However, I would like to point out that the State Department's most recent "Trafficking in Persons Report", released by Hillary Clinton in mid-June, put Cambodia back on the ranking of "tier two watch list". This is partly because: "during 2008, there were reports of prostituted women being detained and physically abused by police and Ministry of Social Affairs, Veterans and Youth Rehabilitation officials."

The American government has not and does not condone the indiscriminate use of prostitution sweeps as a tool to identify sex-trafficking victims. We do, however, encourage law-enforcement operations that remove suspected victims of trafficking from sites of commercial sexual exploitation, with particular

urgency in cases of children in prostitution. We will continue to work to improve the measure of care that is available to victims.

Ambassador Luis CdeBaca
Director
Office to Monitor and Combat
Trafficking in Persons
Department of State
Washington, DC

Chevron in Ecuador

SIR – You published a letter from Steven Donziger, a lawyer representing Amazonian communities in Ecuador in a legal action against Chevron (June 13th). Mr Donziger writes of "toxin-laden formation water", but he has not submitted evidence to support the allegation. He objects to the suggestion that his case is proceeding under a law that is being applied in an unconstitutional, retroactive manner, yet he forgets that his colleagues claim to have had a hand in writing the very law in order for his case to proceed.

Finally, he states that Texaco, now Chevron, endorsed the use of Ecuadorean courts in the 1990s. The United Nations, the International Bar Association, the State Department, and others, have concluded that Ecuador's judicial system was compromised following the 2004 presidential purge of the country's Supreme Court.

Chevron stands by Texaco's performance in Ecuador. The facts warrant such a posture. Despite Mr Donziger's best efforts, facts are stubborn things.

Dave Samson
General manager, public affairs
Chevron
San Ramon, California

Asylum in Britain

* SIR – One reason why the number of asylum applications refused in Britain is much higher than the number of asylum seekers being deported is that, all too often, Home Office asylum caseworkers and adjudicators refuse claims in a hasty, ill-considered, prejudiced and incorrect manner ("After the backlog, a backlog", June 20th). Such decisions are challenged and go to appeal. This forestalls deportations, but also increases the number of those in limbo awaiting appeal or even judicial review.

As a former professor of politics and development I produce expert-witness reports for asylum seekers. A better alternative, in my opinion, would be a fairer and more reliable procedure for initial assessment, bringing in high-quality independent expert advice at an earlier stage. Unfortunately, there seems to be growing government pressure on solicitors not to seek the best independent advice, but to engage in a bidding process for expert witnesses in which cost is the paramount concern. This creates a risk of selecting cheaper "experts" of possibly lower quality.

It would be a sad day if politically motivated pressure to reduce the number of asylum seekers applying for asylum resulted in reduced numbers largely because of inadequate and unfair procedures.

David Seddon
Norwich

Pay racket

SIR – I find it farcical that those who do not want to limit executive pay find no fault with limiting the pay of workers ("Principles, not pitchforks", June 13th). Labour has already been deprived of its fair share of the profits during the past decade and has seen no gain in wages. But when it comes to deciding how bosses are paid, we want to invite the fox into the henhouse to baby-sit the chickens. Ask yourself what

would happen to a company if every employee stayed at home tomorrow. Then ask yourself what would happen if the executive committee were to take a day off.

Brian Muckle
Ottawa

Verbs can add something

SIR – The rather lengthy opening sentence to your article on France's relationship with Africa did not contain a verb ("They came to bury him, not to praise him", June 20th). I realise that we all have to face cutbacks in these uncertain economic times. But no verb in a sentence to confusion.

David Killam
Moraga, California

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* Letter appears online only


WORLD
EUROPE

Russian-American relations

In search of détente, once again

Jul 2nd 2009 | MOSCOW AND WASHINGTON, DC
From The Economist print edition

When Barack Obama goes to Moscow, he will find a sulky former superpower that no longer wants to be part of Western clubs

AP



IN 1988, when the Soviet era was drawing to a close, a Russian rock band, Nautilus Pompilius, recorded a "Farewell Letter" that captured Russia's love affair with America:

> Goodbye America, oh! where I have never been
> Farewell forever...I've outgrown your sand-stoned jeans
> They have taught us to love your forbidden fruits
> Goodbye America, where I will never be.

As Russia was opening up to the world, it was bidding farewell to America as a dream and a Utopia.

Twenty years on, half of Russia's people feel negative about America. They see it as the country's second-biggest enemy after Georgia, which, since last August's war, is also a proxy for the United States. The day after Barack Obama was elected president, Dmitry Medvedev, his Russian counterpart, accused America of using the conflict in Georgia as a pretext for moving NATO's warships to the Black Sea and speeding up the imposition of its missile defence system in eastern Europe. America's unilateralism, he said, was also to blame for the world's economic woes. As a counter to America's missile-defence plans, Mr Medvedev threatened to place rockets in Kaliningrad, Russia's enclave between Poland and Lithuania.

The country which Mr Obama will visit on July 6th to "press the reset button", as he puts it, no longer seeks integration with the West. Anti-Americanism now engulfs even the young and educated, who were untouched even by Soviet propaganda. Curiously, America the enemy is almost as abstract as America the dream. It is not so much a country as a force that pushed Russia to its knees in the 1990s and has since done all it can to stop it getting up again.

A new school textbook teaches Russian teenagers that the West has always been hostile to Russia; that Mikhail Gorbachev, the last president of the Soviet Union, was wrong to see Western partners as allies; and that NATO's expansion into eastern Europe encouraged Western countries to meddle in Russian

affairs. In Russia's view, everything America does in the world is aimed against Russia and everything aimed against Russia is directed by America. Russia measures itself by its ability to stand up to America. But America is also a model of power that Russia wants to copy. Imitation and resentment go together.

Russia's sense of resurgence is mixed with a deeply rooted inferiority complex. A recent remark by Sergei Ivanov, the deputy prime minister and a former KGB general, illustrates the ambiguity. Commenting on the transit of military cargoes bound for Afghanistan, Mr Ivanov said Russia wanted to control what was passing through its territory, because it was "not some banana republic".

The sense of defeat and humiliation which the Kremlin attributes to the early 1990s surfaced several years after the Soviet collapse. In late 1991, far from feeling defeated, most Russians (at least 57% of whom had voted for Boris Yeltsin a few months earlier) saw themselves as victors. And nearly 80% of Russians were positive about America. But the briefly outlawed Communist Party and the KGB felt betrayed and humiliated. A decade and a half later, they have managed to project their feelings on to the whole country.

Russia's current anti-Americanism, therefore, is less a reaction to America's actions than a reflection of its own state of mind. The question is to what extent America's actions have contributed to it.

An opportunity lost

The end of the cold war in 1989 brought a sense of relief and satisfaction to America. As Jack Matlock, America's ambassador in Moscow, described it in his memoirs, "The way we looked at it at the time, and the way Gorbachev looked at it, was that we all won the cold war. We ended it." When the Soviet Union crumbled two years later, America was caught unprepared and scrambling for a policy. Its biggest concern was removing nuclear rockets from former Soviet republics. Yegor Gaidar, Russia's former prime minister in charge of economic reform, says this was one of the most successful operations Russia and America have mounted together.

America's policy towards Russia was not triumphalist. But nor did the West offer Russia a Marshall Plan to stave off a catastrophic collapse in living standards. As Mr Gaidar says, it was more concerned about recovering the Soviet debts which Russia had inherited than with stabilising its financial system. Poland's debt was written off, but Russia's was not. By 1993, when Bill Clinton took office and actively engaged with Boris Yeltsin, the crucial window of opportunity had closed. The funds Mr Clinton managed to accumulate for Russia were too little, too late.

For most of the 1990s, the thrust of Russia's relationship with the West was about Russia's transition to a normal, civilised country. But that clashed with NATO enlargement, which presupposed that Russia was a threat. For the West, enlargement was about bolstering security in Europe. In Moscow it was seen as a sign of mistrust and neglect of Russia's aspirations. A new security structure could have been built to include a democratic Russia, but never was. Instead, NATO enlargement was coated in soothing language about Russia's co-operation with the alliance inside the Russia-NATO council.

Russia can wait

This rang hollow when NATO started to bomb the Serbs, Russia's allies, in 1999. The event was a turning-point in Russia's attitude to America. Suddenly, it felt that its hard-earned seat on the UN Security Council had been turned into a joke, and NATO's enlargement looked like encirclement. Russia's own brutal war in Chechnya made it particularly twitchy. The Russian media, not yet controlled by the Kremlin, went into nationalistic overdrive.

The new attitude towards America was captured in 2000 by a jingoistic film called "Brother 2". The young Russian hero travelled to America to settle a few scores. At the end, after shooting some Ukrainian gangsters, he headed for the airport with his girlfriend. There a customs officer told her that her visa had expired and she could never return to America. She gave the American the finger. The "Goodbye, America!" song rang defiantly over the titles.

George Bush junior took a similarly dismissive line. After the 1998 financial crisis, Russia seemed to be a failing state. Inside the State Department, Russia was demoted and rolled into the Bureau of European and Eurasian Affairs with 53 other countries. "America was not going to look at the region of the former Soviet Union through Moscow's eyes," says Thomas Graham, a former adviser to Mr Bush.

Vladimir Putin, Russia's present prime minister and then its president, took this in his stride. In fact, he was much more accommodating to America in the first two years of his presidency than the Kremlin would now have Russians believe. He did not object to the second stage of NATO enlargement that took in the Baltic states, shut down Soviet-era military installations in Cuba and Vietnam, and "rolled with the punch" when America decided to withdraw from the anti-ballistic missile (ABM) treaty, the symbol of cold war détente. "They told us that if America did not need it, we didn't need it either. It was all based on the assumption that they had won the cold war and would build their own model of security," says Igor Ivanov, Russia's former foreign minister. He quickly realised that protests would get him nowhere.

Andrei Illarionov, Mr Putin's economic adviser until he resigned in protest against rising authoritarianism, says Mr Putin was well aware that Russia faced threats from the south and the east, not from the west. Mr Putin was the first world leader to call Mr Bush after the terrorist attacks of 2001. "He saw September 11th as Russia's unique chance to get under the NATO umbrella," says Mr Illarionov.

Mr Putin volunteered Russian intelligence in Afghanistan, called off military exercises in the Pacific Ocean and helped America gain access to the Central Asian states. To side with America in such an obvious way, Mr Putin had to overcome fierce resistance from Russia's own senior military men. That required political will. Helping America when it was feeling vulnerable not only made Russia look strong, but was also the best way of getting fully accepted into the Western club.

But Mr Bush did not reciprocate. He famously looked into Mr Putin's eyes, but felt he owed him no favours. America did not even bother lifting the Jackson-Vanik amendment, which penalises countries with non-market behaviour and restrictions on emigration. Mr Bush was indifferent to Russia's legitimate concerns but soft on the Kremlin's abuses of power.



According to Alexander Vershbow, a former ambassador to NATO and to Russia, "Bush folks in the first couple of years had this attitude that Russia did not matter and that America should take advantage of any support they offered in Afghanistan and not give them anything in return. They are doing whatever they are doing for their own interest." Unlike Mr Yeltsin, whose friendship with Mr Clinton was based on shared values, Mr Putin believed in pragmatic interests and felt disappointed.

Out of the top fifteen

But the real breaking-point in Russia's relationship with America came after 2003. America's invasion of Iraq, and the Kremlin's attack on Yukos against the background of a rising oil price, coincided to change Russia's direction and subsequently its relationship with the West.

With his fondness for conspiracy theories, Mr Putin decided America's goal was to weaken Russia at any cost. He blamed "outside forces" for a tragic school siege in Beslan, and also saw an American hand behind the Orange revolution in Ukraine in 2004. That looked to him like a dress rehearsal for a revolution in Russia. Meanwhile he saw the war in Iraq, Russia's long-time client state, as an intolerable encroachment on national interests, if not a declaration of war. Mr Putin compared the West to a "strict uncle in a pith helmet" telling other people how to live. But Mr Bush, preoccupied with Iraq, paid little attention.

"Ten American presidents from Truman to Clinton [made] Russia one of their top strategic issues," says Strobe Talbott, Mr Clinton's top Russian adviser. "George W. Bush, if you had asked him what his ten to 15 top issues were—Russia would not be one of them until August 2008 [when Russia invaded Georgia]."

When Mr Putin warned America and its allies against taking Georgia and Ukraine into NATO, the West saw this as posturing. In the end, it achieved the worst of both worlds. It pledged eventual membership to Georgia and Ukraine without offering them a way to achieve it, and it infuriated Russia without promising to defend Georgia. "We have combined strong rhetoric with policies of appeasement," says Joseph Wood, a senior adviser to Dick Cheney, America's former vice-president.

In August 2008, Mr Bush and Mr Putin talked in Beijing about the worsening situation in the Caucasus. When Mr Putin realised that Mr Bush wouldn't or couldn't rein in Mikheil Saakashvili, Georgia's president,

he decided to whack him himself. In invading Georgia, Mr Putin felt he was merely mirroring NATO's actions against the Serbs and America's war in Iraq. But Russia also saw the war in Georgia as a proxy conflict with America and NATO. For a moment, the two countries were close to touching the electrified wire.

Cold-war mentalities

Mr Obama is going to Moscow at a dangerous time. The risk of another war in Georgia is far from over, and the economic crisis has not made Russia any friendlier to the West. By way of a welcome for Mr Obama, Russia has staged the biggest military exercise in the north Caucasus since the end of the cold war. It concludes on the day he arrives in Moscow.

The new American administration, which has mobilised some of the best experts on Russia, has few illusions about the nature of the Kremlin regime: institutionally weak, nationalistic, corrupt and dangerous both to its neighbours and to its own people. But they are also aware that lecturing the Kremlin about its behaviour at home or abroad is useless. "We don't have the ability or even will to use coercive power to change Russia's behaviour," says a senior administration official.

Instead Mr Obama will be talking about America's national interests, in the hope that some of them may overlap with Russia's. The irony is that while Mr Obama and Mr Medvedev have pledged "to move beyond cold-war mentalities and chart a fresh start", the central (and safest) topic of talks is nuclear-arms control, just as it was in the 1980s. The two are aiming to bring their deployed arsenals down below the 1,700-2,000 by 2012 agreed in the 2002 Moscow treaty. An opinion poll this week shows that more than half of all Russians do not support the reductions. "Russia is encircled by American military bases, airports and naval units," cried Vyacheslav Nikonov, a hawkish commentator.

Yet the fact is that, in many ways, Russia needs a new treaty more than America. It cannot afford to start another arms race. "It is back to the future: in the dark days of the cold war, the only piece of real business that the United States and the Soviet Union could do together was not blowing up the world. It may not be the only game in town, but it is the only one that looks pretty clear win-win," says Mr Talbott.

By engaging with Russia on nuclear questions and giving it the status it craves, of a quasi-superpower, America hopes to get traction on other issues, such as Iran and non-proliferation. And if Russia has enough at stake in its relationship with America, it may even decide that the cost of fighting another war in Georgia or destabilising the Crimea is simply too high.

Moscow has registered the change of language. Sergei Prikhodko, the Kremlin's chief foreign-policy adviser, says the style has not become softer, but "we get the feeling that they don't just listen to us, they hear us as well." He says Moscow is also receptive to America's demand to limit any possible leaking of nuclear technologies and material out of Russia. And both Mr Prikhodko and his American counterparts say Russia has been more co-operative on Iran than it appears. "They are certainly not doing certain negative things that they could have been doing there," a senior administration official says.

Much of Mr Obama's policy rests on the assumption that Russia still wants to sit at the same table as America and be integrated into world structures. But this may no longer be the case. Russia does not consider the West as a model of governance or the rule of law, but as a provider of services, including financial ones, for the ruling elite. As Dmitri Trenin, head of the Carnegie Moscow Centre, has argued, Russia has left the West and is trying to build up its influence in the former Soviet space. Mr Putin's decision to pull out of the World Trade Organisation entry negotiations, saying that Russia is prepared to go in only as part of a customs union with Belarus and Kazakhstan, illustrates that point. It came despite Mr Obama's and Mr Medvedev's pledge to jump-start Russia's entry.

But the most difficult issue will remain the fate of Georgia and Ukraine. Russia may not be trying to recreate an empire—it has neither the energy, human resources or ideology for that—but it is trying to prevent the West from entering its sphere of influence. Mr Trenin says that what Russia wants is a buffer zone, with no American military bases or NATO presence. The first targets in Georgia last August were military installations built to NATO standards.

Russia wants a monopoly on the use of force in the former Soviet Union. It also wants to ensure that no conflict can be resolved without its involvement. In advocating a multipolar world, Russia sees itself as one of the poles, dominating its region.

AP



Looking the same way, unusually

Mr Obama’s team will stress that America has no intention of giving up on Ukraine and Georgia. But it will not fight for Georgia militarily or force the issue of NATO membership, not least because neither country is ready. The danger, says Mr Illarionov, is that Russia may interpret any wavering as a signal that America has abandoned Georgia and Ukraine, which might then lead to another military clash.

As one of his advisers puts it, Mr Obama is not a sentimental guy. He will give the Russia relationship his best shot. But if his investment does not yield returns, there is a good chance that Russia will simply drop to the end of his long list of priorities. “We know this is a very serious window of opportunity and nobody should be in any doubt that we want to use it,” says Mr Prikhodko. “But we also have to get answers to the questions we have accumulated over the years. We can ‘reset’ the computer—but what are we going to do with the memories?”

Climate change, health care and the budget

A squeaker, with more to come

Jul 2nd 2009 | WASHINGTON, DC
From The Economist print edition

So many challenges. So little spare cash

Alamy



HAVING campaigned in poetry, Barack Obama doubtless expected to govern in prose. But it is arithmetic that threatens to cramp his ambitions. Last week, the Congressional Budget Office (CBO) released its long-term budget outlook. If current policies are continued, federal debt held by the public will rise from 41% of GDP at the end of 2008 to 87% by 2020, and (theoretically) to a staggering 716% by 2080.

Meanwhile, Mr Obama is trying to save the planet and reshape America's health-care system. The first task will be fantastically expensive. The second does not have to be, but probably will be. A president who refused to put off unpleasant decisions, as Mr Obama promised during his inauguration, would be honest about all this. He would tell Americans that stopping global warming means higher energy prices, and that arresting health-care inflation means cutting back on medical procedures that people want but don't need.

Instead of straight talk, however, Mr Obama has mostly been offering happy talk. When the House of Representatives narrowly passed a climate-change bill on June 26th, he rejoiced that it would create millions of new green jobs and reduce America's "dangerous dependence on foreign oil". Almost as an afterthought, he mentioned that it might do something for the planet. As usual, he gave the impression that planet-cooling will require no sacrifice from voters.

This is drivel. The shift to a lower-carbon economy will destroy jobs as well as create them, and hit growth. Greens wish Mr Obama would use his immense popularity and rhetorical skills to persuade Americans that such costs are outweighed by the benefits of helping to avert planetary catastrophe. But rather than shaping public opinion, he is running scared of it. And so, even more, is Congress.

The House's climate bill is a masterpiece of obfuscation. Buried somewhere in the 1,200 pages of the American Clean Energy and Security Act (also known as Waxman-Markey, after its sponsors) is a sensible cap-and-trade plan to curb emissions of carbon dioxide (CO_2). But it is so weighed down with giveaways, loopholes and needless complexity that many environmentalists hesitate to support it.

The bill calls for the government to issue a fixed number of permits to emit CO_2 each year, which firms

must buy before releasing the stuff into the atmosphere. The permits will be tradable, and their number will gradually decline. The goal is to use them to reduce America's CO_2 emissions by 17% (from the level in 2005) by 2020 and by 83% by 2050.

The outline is fine, but the details are not. Mr Obama wanted the permits to be auctioned, which would raise large sums (which were meant to help finance health-care reform) and allocate the permits to the firms that value them most. Instead, the House decided to give away 85% of them free to politically-favoured entities.

Some say this was necessary—the bill only passed by a whisker, 219 votes to 212, and would probably have failed without the giveaways. The mid-term elections, after all, are only 16 months away. A poll for *The Economist* by YouGov (see chart) found that 62% of Americans want carbon curbs, but only 30% would pay even $175 a year for them, and only 7% would pay $770. Republicans snarl that Democrats want to tax Americans every time they flip a light switch. Free permits for electric utilities will help keep electricity prices low. But it will also undermine the object of the bill. If power is cheap, people will use more of it, and emit more carbon.

The problem with democracy
National poll, % replying:
how serious a problem is global warming?
0 10 20 30 40 50 60
Very
Not very
has global warming been caused mainly by?
0 10 20 30 40 50 60
Human activity
Natural causes
would you support a climate bill if the annual cost per household was?
Favour Oppose
0 20 40 60 80
$80
$175
$770
Source: YouGov/Polimetrix poll, June 28th-30th 2009

It gets worse. A new provision, added just before the vote, would oblige the president to impose tariffs on goods from countries that do not limit greenhouse-gas emissions. This is probably illegal under WTO rules and could start a trade war with China and India. Even Mr Obama choked on it. "I think we have to be very careful about sending any protectionist signals out there," he said. But would he veto?

Another new provision greatly increases opportunities for farmers to make money by selling "offsets"—that is, reducing their own CO_2 emissions so that someone else does not have to. Farm-state representatives ensured that this process will be overseen by the Department of Agriculture, which loves giving money to farmers, rather than the Environmental Protection Agency, which has different priorities.

The CBO was asked to estimate the bill's direct costs to consumers in 2020. It came up with a figure of $175 per year, per family. "Less than the cost of a postage stamp a day!" crowed Democrats. But that is an illusion. In 2020 the bill will not yet have started to bite, and the estimate excludes its effect on economic growth.

The bill now goes to the Senate, which might make it less protectionist and more supportive of nuclear power. But since the Senate has an even stronger rural bias than the House and requires a supermajority of 60 to avoid filibusters, things could get even messier. Mr Obama needs to find at least $1 trillion to overhaul health care, and those plans now face an uphill battle of their own in the Senate, which looks set for a long hard summer.

The Democrats do now have 60 senators (see article), and they might pick up a Republican or two; but they cannot afford many defections. No fewer than 44 House Democrats, almost 20% of the total caucus, voted against the bill. The Senate marches to a different drum than the House does, with senators facing re-election only every six years, not every two. But the prospect of voting for two very expensive and not very effective packages will make a few Democratic senators swallow hard.

Mr Obama promised, on the campaign trail, not to tax private health benefits. He also promised to cut taxes for all but the rich. Arithmetic suggests he will have to break his word on something.

A comedian in the Senate

Eight months later

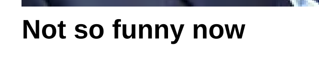
Jul 2nd 2009 | CHICAGO
From The Economist print edition

Al Franken prevails at last in Minnesota

ON JUNE 30th, 238 days after the election last November, Minnesota's Supreme Court ruled unanimously that Al Franken is entitled "to receive the certificate of election as United States Senator from the State of Minnesota". The margin of victory was just 312 votes, after months of recounts, court hearings and general frustration. Norm Coleman, his Republican opponent, announced that he would not appeal to the United States Supreme Court, which might have dragged things out even longer.

Not everybody in Minnesota has been gripped by the fight. One town was so bored that it planned to choose a winner by staging a race between two piglets named after the candidates. But national Democrats have been waiting breathlessly for the contest to be resolved. When Mr Franken is seated, probably in the week of July 6th, he will become the Senate's 60th Democrat, giving his party the number it needs to break a Republican filibuster, so long as they all turn up (two of them are seriously ill) and vote as they are told to.

Reuters



Not so funny now

Even if the race had not dragged on or if Mr Franken were not the cherished 60th senator, his rise to power would have been remarkable. He became famous in the 1970s as a rowdy comedian on "Saturday Night Live". He went on to become a commentator on Air America, a radio station positioned somewhere to the left of San Francisco, and wrote books such as "Rush Limbaugh is a Big Fat Idiot".

But Mr Franken worked hard to earn the right to represent Minnesotans in Washington. Raised in Minnesota, he spent most of his adult life elsewhere and moved back in 2005. He spent the next years raising money for local Democrats and traversing the state with open ears. The state fair featured one of his wife's enormous, domed apple pies. Mr Franken attended event after event for the Democratic-Farmer-Labour Party (as Democrats are known in Minnesota). By the time he had a campaign office—which displayed a portrait of the candidate made entirely of seeds—he had become a more thoughtful advocate for education, health care and agriculture.

At his victorious press conference Mr Franken tried to cast himself not as the 60th Democratic senator, but as the second senator from Minnesota. He will try to make a humble entrance in the Senate, following the lead of that other polarising celebrity, Hillary Clinton. But the 60th senator he is, and lest Mr Franken be in any doubt about his duty in coming debates, Barack Obama issued a brief, congratulatory statement that he looked forward to working with the new senator on "lowering health-care costs and investing in the kind of clean energy jobs and industries that will help America lead in the 21st century."

Green spending and stimulus

Curiously slow

Jul 2nd 2009 | NEW YORK
From The Economist print edition

The energy secretary continues to show his frustration

Illustration by Claudio Munoz



THE economy is wobbly, oil prices are rising and voters have climate change on their minds. What better, surely, than a "green stimulus"? Barack Obama duly set aside some $39 billion of February's $787 billion stimulus bill for the Department of Energy, hoping to create lots of sustainable, high-tech "green jobs". Steven Chu, the secretary of energy, was in Iowa on June 22nd to announce $16m in spending—soon to grow to $40m—on green fuels and energy efficiency there. "I want to shove this money out the door as quickly as possible," said the secretary. And well he might. Just $5.8 billion of that $39 billion had been allocated as of June 19th. The department is trying hard to spend the cash faster, and has since then made a flurry of announcements (see article).

Why has spending money proved so hard, when the whole point of the stimulus was to jolt the economy quickly? One problem is structural: the department has historically focused mainly on America's nuclear-weapons stockpile. The modern role of funding green-energy projects has grown in prominence, but that old priority still sucks up the biggest share of the department's people and money.

The second difficulty is the sheer size of the stimulus: the extra $39 billion dwarfs the department's pre-stimulus total annual budget of just $26 billion. The department was already the largest civilian contracting agency in the government (only the Pentagon is bigger), and was already understaffed. From 1998 to 2008 its procurement grew by 61% while its staff numbers went up by just 20%. Now the amount of money it has to push out of the door is greater still; but there are obvious dangers in trying to move it out too quickly.

Besides awarding new types of contracts and grants, the Department of Energy has pre-existing loan-guarantee and direct-loan programmes for energy projects that have been boosted by the stimulus money. When Mr Chu took office, he was said to be infuriated by how slowly the loan-guarantee programme was working. The department's chief adviser for stimulus spending, Matt Rogers, says that simple changes have been made: it no longer takes three months just to appoint a financial analyst or engineer to investigate an application. And the number of staff overseeing the loan-guarantee schemes is meant almost to triple, from 35 to 95, this year.

The department has also made an unusual appeal. Earlier this year it asked universities and trade associations for volunteer experts to help vet loan applications. Two weeks later more than 2,000 boffins had offered help. The experts are being sorted into specialist teams and will soon start scrutinising applications.

Some of the projects still have their critics. Mr Chu was in Iowa to boost corn-based ethanol, a fuel that is barely greener than petrol. And the administration is reviving FutureGen, a pilot project to burn coal and produce electricity while capturing and storing the carbon; the Bush administration had abandoned it, and many see it as a boondoggle for big coal and a sop to electorally crucial coal states. Once cap-and-trade is in place (if it ever passes the Senate), it will be easier for the market to have its say on such schemes.

A year at the Supreme Court

Fairness for firefighters

Jul 2nd 2009 | WASHINGTON, DC
From The Economist print edition

The court grapples with baffling racial laws, and much else

Reuters



The Supremes tripped Sotomayor

THEY celebrated with a Stars-and-Stripes-iced cake. On June 29th the Supreme Court ruled in favour of white and Hispanic firefighters who were discriminated against by the city of New Haven, Connecticut. Six years ago the city put them through an exam to decide whom to promote. When no black scored highly enough, it scrapped the test and promoted no one. The passed-over firefighters sued.

The city said the test must have been unfair. By a 5-4 majority, the Supreme Court disagreed, finding it both fair and relevant. The ruling added a little clarity to America's incomprehensible racial laws. Employers sometimes face a Catch-22: they are barred from treating employees differently because of their race, but forbidden from treating everyone the same if that has a "disparate impact" on one group.

The city argued that it would be sued by black firefighters if it honoured the test results. But the Supreme Court said it should only have been liable to such a suit if there was "a strong basis in evidence" that the test was not job-related or that the city had rejected an equally valid test that more blacks would have passed.

The case sparked breathless headlines. One of the lower-court judges who dismissed the firefighters' complaint was Sonia Sotomayor, Barack Obama's first pick for the Supreme Court, whose Senate confirmation hearings start on July 13th. None of her soon-to-be colleagues shares her view that a test can be discarded solely because minorities do badly on it. But while this is embarrassing for the nominee, her confirmation by the Democratic-controlled Senate still seems to be in no doubt.

The ruling exemplified the cautious approach to judging championed by John Roberts, the chief justice since 2005. Rather than seeking to scrap the whole notion of "disparate impact" law, as some of his more conservative colleagues would have preferred, he was content to restrict the scope of its application. In general, he says that if a case can be decided on narrow grounds, it should be, and he appears to mean it.

Sometimes, his restraint is dictated by circumstances—he cannot win a case without four other judges on his side, and the court is closely divided on many issues. Roughly speaking, there are four liberals (Ruth Bader Ginsburg, John Paul Stevens, Stephen Breyer and David Souter, who retired on June 29th and whom Ms Sotomayor is meant to replace), four conservatives (Clarence Thomas, Antonin Scalia, Samuel Alito and Mr Roberts) and one swing voter (Anthony Kennedy). In close cases, the court typically divides along ideological lines, with Mr Kennedy casting the deciding vote.

The court's most recent session, which ended this week, yielded more 9-0 decisions than 5-4 splits, though unanimity is rarer now than it was during Mr Roberts's first year. But whereas past courts have sometimes been politically assertive, for example by wresting control of abortion policy from the states in 1973, the Roberts court prefers to let elected politicians sort out such contentious social issues. It seems in no hurry to rule on gay marriage, for example, which some states have legalised without compulsion from judges.

It is also standing back while Mr Obama crafts a new policy for handling terrorist suspects. In *Kiyemba v Obama*, a case involving Uighur separatists from China who are held at Guantánamo Bay but are not

deemed to pose any threat to America, it opted to make no decision until October. The court seems reluctant to pre-empt Mr Obama's efforts.

The court has been hostile to environmentalists of late, ruling against them five times out of five this session. For example, it allowed the navy to use sonar during exercises despite possible injuries to whales, and ruled that the Environmental Protection Agency could weigh costs against benefits when regulating water pollution, despite howls of protest from green absolutists.

Nearly 60% of Americans now say that they approve of the way the Supreme Court is doing its job. Before Mr Obama's election, Republicans approved and Democrats did not. In June, even though the make-up of the court had not altered, it was the other way round. That's the Obama effect for you.

State budgets in crisis

Happy new year

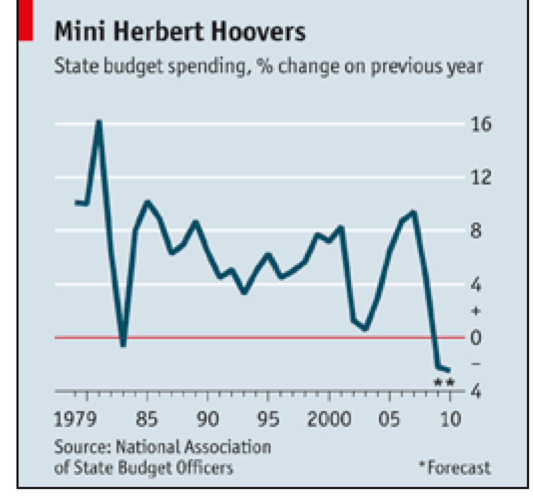
Jul 2nd 2009 | AUSTIN, CHICAGO, LOS ANGELES AND NEW YORK
From The Economist print edition

The pain of balancing budgets

THE mantra in Washington, DC, is simple: spend billions now, pay later. Congress has been crafting ambitious plans for energy, health care and transport. But the mood in state capitals has been different. Forty-six states had a deadline of June 30th to pass their budgets. Just as important, those budgets had to be balanced. With the sole exemption of Vermont America's state governments, unlike the federal one, are not allowed to run deficits. For many states June was an agonising month.

Every state but two, commodity-rich North Dakota and Montana, has faced a deficit this year. One legislator in New Jersey described her state as "functionally bankrupt". More than 5,000 Illinoisans gathered on June 23rd to protest against cuts to social services, with a child placed in a coffin for dramatic effect. In California, which faces a $24 billion gap, Arnold Schwarzenegger, the governor, sent the leader of the state Senate a metallic pair of bull testicles to urge him to cut spending.

On the morning of July 1st, the first day of the new fiscal year for most states, taxpayers had reason to be glum. Connecticut, North Carolina and Ohio had passed temporary extensions. California, Arizona, Pennsylvania and Illinois did not have a balanced budget as required. As *The Economist* went to press, California's controller was preparing to pay the state's bills with IOUs instead of cash. Most states that did pass budgets imposed painful cuts, higher taxes and fees on everything from pesticides in Minnesota to hunting licences in Maine. Total spending is set to decline for the second consecutive year, says the National Association of State Budget Officers (NASBO), the biggest drop in more than three decades (see chart).



Forty-two states had already trimmed their budgets in the middle of the year, according to NASBO. The three main sources of general revenue are personal income, sales and corporate income taxes. Each failed to meet expectations. Yet as soon as politicians responded to new, lower revenue collections, the floor beneath them sank yet again.

Matters would be worse if it were not for Washington's stimulus package, which provides more than $135 billion to support state budgets. Most money, $87 billion, is for Medicaid, the government's health-care programme for the poor. A further $48 billion created a State Fiscal Stabilisation Fund, mostly for schools and universities, with $9 billion for flexible grants. Despite some grandstanding, every governor accepted help. The governor of South Carolina (see article) tried to reject the stimulus, but he was overruled first by his legislature and then by the state's highest court.

However $135 billion goes only so far (though it did, for instance, allow Texas to close its deficit and pass its budget). Most of it will be spent in 2009 and 2010. The gaps for fiscal year 2010 alone amount to $166 billion, according to the Centre on Budget and Policy Priorities (CBPP), a research group based in Washington, DC. The CBPP estimates that by the end of fiscal 2011, the cumulative fiscal gaps in the 50 states will exceed $350 billion.

There are three main ways that a state can close a deficit: raid reserves, raise taxes or cut spending. Though the Republican governors of Indiana and Texas were reluctant to tap their "rainy day" funds, many other states decided that the storm had come and withdrew copious amounts. Louisiana's legislators were among those to shun a tax hike of any kind, but since January at least 37 states have raised or are considering raising taxes and fees. Hawaii created three new income tax brackets. Illinois's governor wants to raise the income tax by a whopping 50%.

Some states have taken a gentler route. Those yearning to film in Kansas will no longer get a tax credit for doing so. Many states chose to target sin, raising taxes on cigarettes and alcohol. But states punished more benign activities too. Maine, as part of its efforts to broaden its revenue base, extended its sales tax to car repairs, dog grooming and dry cleaning. South Dakota increased charges on laundromats.

Raising taxes has not prevented cuts. Some states have slashed bloated programmes such as prisons. A handful of states have sacked workers; many more have frozen hiring or are asking workers to take furlough (compulsory unpaid leave). New Hampshire has agreed to cut $25m in personnel costs, either through lay-offs or furloughs. If the latter, the governor has even agreed to furlough himself.

Cuts to social services and education may be the most painful. Since the start of the recession at least 32 states have reduced money for universities or raised student fees. Not long ago states were rushing to establish themselves as models for health-care coverage. But at least 21 states have cut back their health programmes, according to the CBPP. Massachusetts, the first state to attempt universal coverage, is slashing its health budget by 12%.

The full extent of cuts is still unknown in states without a valid budget. Illinois and California, in particular, are in limbo. Both were in bad shape even before the recession. Years of excessive spending have taken a toll on Illinois. Legislators have yet to agree on how to fill this year’s deficit. It would help if they could agree on the deficit’s size. California, however, probably holds the dismal honour of being America’s most dysfunctional state. Its levels of spending are unsustainable, but legislators seem powerless to do anything about it. Gerrymandered districts produce extremist politicians, among whom agreement is all but impossible since two-thirds majorities are needed to pass budgets and impose new taxes.

Even when these laggards do pass their budgets, the pain will continue. Fresh gaps of $23 billion have already opened in the newly-adopted budgets of at least 12 states. When the national economy recovers at last, state revenues may not. Usually, tax collections rise more slowly than the broader economy.

Many economists fret about an unpleasant scenario in 2011, when the stream of stimulus money will ebb, reserves will have been drained and revenues will still be meagre. Medicaid enrolment may still be swollen by recession. Promises to retired workers, including pensions and health care, will weigh more heavily than they do now. This year was painful, but those to come may be even worse.

Unemployment insurance

More money, more problems

Jul 2nd 2009 | AUSTIN
From The Economist print edition

A few Republicans are holding out against more unemployment insurance

MARK SANFORD, the Republican governor of South Carolina, is a strict fiscal disciplinarian. When Washington announced its economic stimulus plans last year, he opposed the whole idea. At the time his state's unemployment rate was among the highest in the nation, and in December the fund that doles out unemployment benefits ran out of money. As the months went on South Carolina's situation only worsened and Mr Sanford accepted bits of federal money here and there, complaining all the while. And in June the South Carolina Supreme Court ordered him to request the unemployment money.

Critics accused him of grandstanding with an eye to the 2012 presidential election—at least until his chances were sunk by a scandal involving adultery, Argentina and the Appalachian Trail: Mr Sanford may have to stand down as governor. But Haley Barbour, the Republican governor of Mississippi, is ready to take his spot. Earlier this year he said he did not want federal money for unemployment insurance because it would force Mississippi to pony up for people who are "not willing" to take a full-time job. Mississippi's malingering rate has soared to 9.6%, but Mr Barbour has not relented.

No part of the stimulus bill has been more controversial than the attempt to expand unemployment insurance. The stimulus allots $7 billion for states that agree to updated eligibility rules for unemployment benefits. But the state must first agree to calculate benefits using an "alternative base period" which takes into account the most recent wages earned. The state also has to agree to at least two further expansions, such as extending benefits to part-time workers or to people who want to pursue job training. The idea is to reach more low-wage workers, women, and people who recently entered the workforce.

Several states already had such rules, or only had to make minor tweaks; others wanted the money and quickly made the changes. But there are a handful of holdouts: Mississippi, Virginia, Florida, Texas, Louisiana, and Alabama. They maintain that taking federal money now will commit them to increased spending even after the federal funds dry up, and the expanded eligibility will mean more taxes on business.

Some will no doubt crumble: Florida's unemployment fund is projected to run out in the autumn. A few will maintain their resolve, most likely Texas and Louisiana, where unemployment is several points below the national average and circumstances not so dire. Tim Barfield, the head of the Louisiana Workforce Commission, says that part of the thinking in his state is that they are behind the curve in terms of economic development, and need to become a tax-cutting, business-friendly kind of place. The federal funds are available until 2011, should any of the governors have a change of heart.

Captain Hudson's journey

Fair to foul and back again

Jul 2nd 2009 | NEW YORK
From The Economist print edition

The Hudson River, 400 years on

Corbis



AS AMERICA celebrates its birthday on July 4th, New York is celebrating the discovery of its Hudson river. The Dutch East India Company hired Henry Hudson, an English explorer, to find a north-west passage to Asia. He failed: the route defied all explorers until Roald Amundsen in 1906. But Hudson's journey of 1609 up the river that would later bear his name led to a valuable trade in furs and eventually to settlement by the Dutch. His shipmate recorded abundant fish and that the surrounding lands "were as pleasant with Grasse and Flowers, and goodly Trees, as euer they had seene, and very sweet smells came from them." The smells unfortunately, have not always been so sweet.

The Hudson has been exploited and abused. Factories used the river as a dumping-ground. At one time a 20-mile stretch of the Hudson had little or no aquatic life. "You could tell what colour the GM plant in Sleepy Hollow was painting its cars by the colour of the water," recalls Alex Matthiessen, president of Riverkeeper, an environmental watchdog. Since the 1960s, groups like Riverkeeper and advocates such as Pete Seeger, a folk singer, have fought to restore the river's ecosystem. The 1972 Clean Water Act helped deter polluters. And in 1984 the federal Environmental Protection Agency classified 200 miles of the river as a Superfund site, eligible for special attention. As a result of all this the river has begun to look like its old self. Water quality has improved. Some fish populations look healthier. The Bald Eagle once again nests nearby.

There are still concerns. Indian Point, a nuclear power plant in Westchester, uses up to 2.5 billion gallons (9.5 billion litres) of river water a day. The water is then discharged back into the Hudson. According to Riverkeeper, the hotter discharged water kills large numbers of fish, larvae and eggs. Indian Point says there have been no temperature-related deaths. There is also considerable contamination by PCBs, toxic chemicals with carcinogenic effects. After years of delays General Electric has now begun a process of dredging to clean up the contaminants. But it was already safe to swim with the fishes, except after heavy rain. Antiquated sewage systems in New York City and in towns and cities further up river cannot handle storm surges.

The Netherlands still retains an interest in its former New Amsterdam. The country is America's fourth largest investor. It is participating in many of the festivities, including a big flotilla last month. New York's July 4th fireworks display is taking place on the Hudson. In September a replica of Hudson's ship, the *Half Moon*, will re-enact the captain's journey. But he wasn't the first to discover the river, of course. Native tribes lived along the "Mahicantuck" for thousands of years.

Lexington

Two cheers for America

Jul 2nd 2009
From The Economist print edition

The current Lexington bids farewell to America after 13 years

Illustration by David Simonds



ALEXIS DE TOCQUEVILLE was so enthralled by the nine months he spent in the United States in 1831 that he wrote two fat volumes about the country. He admired the vigour of its democratic institutions and the entrepreneurial spirit of its people, which was rapidly transforming a vast wilderness into a polished civilisation. And he approved of the way that the country's potential vices were moderated by its commonplace virtues, particularly its civic pride and religious observance. The proud French aristocrat was happy to call himself "half Yankee".

But in the 1840s and 1850s de Tocqueville's views on America took a darker turn, as a new collection of his writings makes clear. ("Tocqueville on America After 1840: Letters and Other Writings"). Public life was dominated by people who lacked "moderation, sometimes probity, above all education". America's sense of "exaggerated pride in its strength" was promoting military adventurism. "Primitivism" stalked the land. "What is certain is that, for some years, you have strangely abused the advantages given to you by God," he chided.

It is presumptuous to mention oneself alongside the author of the greatest book written about America. But during the 13 years that the author of this column has spent in the United States, he too has found his initial exuberance clouded by darker thoughts. When he arrived in 1996, America was lord of all it surveyed, the world's only remaining superpower, convinced of its supreme benevolence, and the engine of a productivity miracle that left Europeans in awe. Social pathologies such as violent crime were being brought under control; almost half of households owned shares. The place had an air of what Mark Twain once called "the serene confidence which a Christian feels in four aces".

Today, this serene confidence has long gone. Americans are more pessimistic than the Indians or Chinese, worried that their children will not enjoy the opportunities that they have taken for granted. Xenophobia is on the rise, as is nostalgia for a time of stable families and solid values. California, the state that has always reached the future first, is preparing to pay its bills with IOUs.

America has had an inauspicious start to the 21st century, to put it mildly. The Iraq war revealed the fragility of the "unipolar moment". America sullied not just its moral authority, thanks to Abu Ghraib and "enhanced interrogation", but also its reputation for competence, thanks to faulty intelligence about WMD and a botched occupation. The economic crisis has revealed the fragility of its financial system. Great

investment banks have crumbled to dust. Financial wizards have been exposed as frauds or fools. A country that once lectured the world on the "Washington consensus" of deregulation and privatisation is busy re-regulating Wall Street and nationalising Detroit.

America has got ever deeper into debt, unable to kick the habit of living beyond its means. The cost of entitlements has been rising vertiginously, and will do so even faster as the baby-boomers retire. The federal deficit is likely to average a trillion dollars a year over the next decade. Sober projections suggest that by 2027, if federal revenues remain at around 18% of GDP—the level people are accustomed to—they will not even cover the cost of government-run health programmes, Social Security and debt interest. Everything else will require more borrowing. Foreigners, who currently hold around half of US Treasury debt, up from 18% in 1990, will not finance Uncle Sam's self-indulgence for ever.

But we should guard against substituting irrational pessimism for irrational exuberance. Yes, America will face competition from developing countries and from an enlarging and deepening European Union. But it brings great resources to the fight. China's authoritarian regime is brittle. About 40% of India's people are illiterate, and its pool of trained talent is limited. America will be spared the demographic disasters awaiting Europe and China, thanks to its high birth rate and genius for absorbing newcomers.

A genius for self-correction

De Tocqueville, in his optimistic phase, said that "the greatness of America lies not in being more enlightened than any other nation, but rather in her ability to repair her faults." America has succeeded brilliantly in repairing the ancestral fault of racism. Thirty-six years after Richard Nixon casually remarked that "there are times when an abortion is necessary…when you have a black and a white," America elected the child of a black father and a white mother to the presidency. The new administration is trying to correct some of the excesses of the Bush years, much as Ronald Reagan corrected the excesses of the Carter years. Barack Obama wants to tackle health-care costs and rebuild the economy on the rock of solid education and a sound infrastructure rather than the sands of financial speculation.

Whether Mr Obama can deliver on his promises is open to doubt: his inspiring rhetoric is marred by a willingness to compromise with his party's free-spending establishment in Congress. But there is fortunately a more solid reason for optimism. That is the country's taste for entrepreneurial capitalism, a taste that arrived with the first settlers and is becoming an ever greater resource, as the global economy is shaken by wave upon wave of disruptive technologies. America still has a genius for incubating entrepreneurs and giving those entrepreneurs the wherewithal to turn bright ideas into global behemoths. America's biggest company, Wal-Mart, was founded only in 1962; its sexiest, Google, was conceived in a Californian dorm room at about the time that your columnist arrived on these shores. Even as de Tocqueville despaired about the future of his half-adopted country in the 1840s and 1850s, the likes of Carnegie and Rockefeller were about to unleash the greatest productivity miracle the world has seen. That is the America that still promises much.

Economist.com/blogs/lexington

The coup in Honduras

Defying the outside world

Jul 2nd 2009 | TEGUCIGALPA
From The Economist print edition

Hondurans are pleased that an old-fashioned coup has installed a new president; the rest of Latin America is appalled

EPA



HE IS an unlikely figure to have become an international *cause célèbre*. Manuel Zelaya is a moustachioed timber magnate who won Honduras's presidential election in 2005 as a law-and-order candidate for the mainstream Liberal Party only to alienate most of the country by allying himself with Hugo Chávez, Venezuela's leftist president. His overthrow in a military coup on June 28th was followed by calls for his restoration of striking unanimity and vehemence, from Barack Obama, Mr Chávez, the Organisation of American States (OAS) and the United Nations General Assembly, among others.

The only people who don't seem to want the president back in his job are Hondurans. On June 30th thousands of them filled the main square in Tegucigalpa, the capital, to show their support for Mr Zelaya's removal and his replacement by Roberto Micheletti (pictured above, with microphone), the head of Congress. "We don't want Mel! Out, Mel!" they screamed, using Mr Zelaya's nickname. "It was legal! It wasn't a coup!" The previous day only a few hundred pro-Zelaya protesters had taken to the streets, burning tyres and throwing stones at soldiers before being dispersed with tear gas.

These numbers may not tell the whole story. Behind the new government stands the army. After 200 soldiers arrested Mr Zelaya and deported him, armoured cars patrolled Tegucigalpa and fighter jets flew overhead. A private television channel that backed the president was silenced, while others have observed a news blackout. Some 60 people are reported to have been injured in clashes. Even so, there is no evidence of Hondurans clamouring for the president's return with anything like the enthusiasm of outsiders.

That is because most have tired of his rule, and blame him for the constitutional crisis that preceded the coup. It was precipitated by his attempt to emulate Mr Chávez by organising a referendum to call a constituent assembly, which he seemed to hope would allow him to remain in power beyond January, when his four-year term ends. Under Honduras's constitution, only Congress can call referendums and it was against one. Mr Zelaya went ahead anyway. When the head of the armed forces refused to carry out an order to distribute the ballot papers, the president sacked him. The Supreme Court reinstated the general, and the electoral tribunal ordered the ballots to be confiscated. In response, Mr Zelaya led a

group of supporters to an air force base where they carted off the ballots. He instructed public employees to collect signatures for the constituent assembly. Hours before voting was to begin, the army seized the president.

The army said he was arrested for defying the Supreme Court, though no explanation has been given for why he was not brought before a Honduran judge. The legislature then voted almost unanimously to install Mr Micheletti, a Liberal rival of Mr Zelaya, as his successor. Congress has no constitutional power to remove the president. Mr Micheletti produced a curiously worded resignation letter which Mr Zelaya denies having written or signed.

These events took the region by surprise. Honduras, although poor and ravaged by corruption and violent gangs, had a seemingly stable democracy. But signs of strife were there. Mr Zelaya's presidency has been marked by a rise in crime, corruption scandals and economic populism. He pushed through big wage increases for teachers and government workers. When money ran short, he turned to Mr Chávez for petrodollars. Despite more than $100m in Venezuelan aid, the government has stopped paying some suppliers.

In opinion polls, Mr Zelaya's approval rating sank to 30%. Mr Chávez is unpopular in a conservative country with close ties to the United States, its main trade partner. Honduras's media are full of allegations of infiltration by communist agents and drug traffickers from Venezuela and Nicaragua. But Mr Chávez's attempts to link the United States to the coup were undercut by Mr Zelaya himself. In an interview with *El País*, a Spanish newspaper, hours before he was ousted, he thanked the United States for opposing the army's plans for a coup.

No country in the Americas has recognised Mr Micheletti. All Latin American countries and Spain (although not the United States) have withdrawn their ambassadors pending Mr Zelaya's reinstatement. But how might that come about? Mr Chávez has threatened insurrection (and even invasion). In Venezuela in 2002 he was restored to power after a brief coup faltered. But Venezuela's army and its opposition were divided, and the *chavistas* well-organised. In Honduras the army and all the main political parties are united in opposing Mr Zelaya, whose only backers are trade unions, leftist social movements and some among the poor.

On July 1st the OAS gave Honduras three days to restore constitutional order or risk suspension from the organisation. A solution may require lengthy negotiations. Having initially vowed to fly home later this week, Mr Zelaya desisted, after officials in Tegucigalpa said he would be arrested for treason. He has already said that if reinstated he would drop all plans for another term and leave in January.

Honduras's neighbours have closed its borders to trade for two days. The World Bank has suspended aid; having initially said they would not, American officials mulled doing the same. Honduras's economy depends on exports (of coffee, bananas and textiles), tourism and remittances from workers in the United States. All would be imperilled if its government remains a pariah. But Mr Micheletti will not find it easy to cede his job to a man who is abhorred by most of his people and all of the powers that be in his country.

Argentina's mid-term election

Walloped

Jul 2nd 2009 | BUENOS AIRES
From The Economist print edition

The Kirchners lose a referendum on their rule

AP



De Narváez knocked out Kirchner

WHEN Argentines last voted in a national election two years ago they chose Cristina Fernández as their new president with 45% of the vote and no need for a run-off. They gave the political block controlled by her and her husband and predecessor, Néstor Kirchner, healthy majorities in both houses of Congress. In a mid-term election on June 28th not only did the first couple lose those majorities but they also lost the political dominance they have exercised over Argentina since 2003. They show few immediate signs of heeding the demand for change.

In the lower house, where half the seats were in play, the Kirchners' supporters now have just 115 of the 257 seats. They lost three seats in the Senate, which is now evenly balanced. Across the country, their vote sank to around 30% in an election that Mr Kirchner had framed as a referendum on the first couple's leftist, populist version of Peronism. He stood himself in Buenos Aires province, where nearly 40% of Argentines live, but came second, beaten by a group of dissident, centrist Peronists headed by Francisco de Narváez, a wealthy businessman.

There were other hugely symbolic defeats, such as in Santa Cruz, the Patagonian province where Mr Kirchner was governor before he became president. Ms Fernández sought solace in the performance of Fernando Solanas, a leftist filmmaker, whose new grouping came second in the capital district, winning 24% (though he campaigned as an opponent). The opposition is split into two broad blocks—the Peronist right and the Radicals, each with rival leaders. But both are now much stronger.

Argentina seems to feel uncomfortable with a weak leader. In the current democratic period starting in 1983, two presidents, both of them Radicals facing deep economic woes, were forced to step down early after losing their congressional majorities. In 1997 Carlos Menem, a Peronist, lost his majority, but he survived by cultivating good relations both with the opposition and the provincial governors. That has not been Ms Fernández's way. Argentina is now again in recession. Partly because of drought but also because of punitive taxes, it may have to import wheat next year for the first time since records began. The next two years may be rocky.

This week the president was characteristically haughty and defiant in a defeat she refused to recognise as such. Mr Kirchner gave up the leadership of the Justicialist (Peronist) Party, but turned it over to an ally. The health minister resigned, as officials belatedly accepted the severity of swine flu in Argentina, which they had resisted doing before the vote. There were signs of a wider cabinet shuffle, though not necessarily of policy changes. His offer of talks seemingly spurned, Mr de Narváez complained: "The government is autistic, removed from reality."

The new Congress will not assemble until December. Even then, the president could rule by decree. Opponents want the government to fire those responsible for doctoring economic statistics, and to cease its harassment of the private sector. The risk premium on Argentina's bonds has fallen by more than three percentage points over the past month. The opposition still has much work ahead. The Radicals need to rebuild their weakened party machine. And the Peronists need to rally round a new leader. But the Kirchners' dreams of alternating in office for another decade are over.

Brazil's licensed thinker

A sage exits, maybe left

Jul 2nd 2009 | SÃO PAULO
From The Economist print edition

The government's in-house philosopher returns to Harvard

ONE of the mysteries of Brazilian politics these days is what the governing Workers' Party (PT) believes in. It was born in 1980 with an ideology that mixed Marxism and liberation theology and promised nationalisation, land redistribution and debt default. In power under President Luiz Inácio Lula da Silva, it has done none of these things.

Enter into the government, as minister for strategic affairs, two years ago Roberto Mangabeira Unger, a Harvard law professor and philosopher. Mr Unger is not a member of the PT, but he is the author of expansive books with titles like "What Should The Left Propose?" Could he fill the vacuum?

He quickly came up with a plan for the Amazon, which included a reorganisation of land tenure. There were also plans for the poor north-east, and for the armed forces, with a proposal for national service to turn Brazilians into citizens. Mr Unger also dabbled in diplomacy, representing Brazil in meetings with other big emerging powers. In his spare time, he produced papers on financial reform and ran a one-man campaign to undermine the foreign ministry's enthusiasm for the Doha world-trade talks.

His thinking is a curious melange of leftism, dirigisme and liberalism whose Cartesian logic sometimes seemed crystalline only to himself. This week he announced his return to his tenured professorship, pension and family at Harvard. His departure will relieve many of his colleagues, but leaves the government more boring. And there is still no answer to what the PT believes in.

Mexico's mid-term election

Tilting to the PRI

Jul 2nd 2009 | MEXICO CITY
From The Economist print edition

Felipe Calderón's battle for relevance

FOR 70 years the Institutional Revolutionary Party (PRI) was synonymous with the state in Mexico, before it was finally booted out of the presidency in an election in 2000. It has since tried hard to reinvent itself as a competitive political party operating in a democracy. In the campaign for a mid-term election on July 5th involving all 500 seats in the lower house of Congress, PRI candidates across the country have solemnly trooped into public notaries' offices to turn their campaign promises into formal pledges. These mix opposition to national reforms such as taxing food and medicines with local issues such as paving roads.

The PRI is also touting its experience and a new focus on honesty and accountability. Some Mexicans question how far this goes, since it continues to close ranks around corrupt officials rather than expel them. But after finishing a distant third in a presidential election in 2006, opinion polls now give it a slim but stable lead over the conservative National Action Party (PAN) of President Felipe Calderón. That would translate into a near-doubling of its current 105 seats in the lower house of Congress, and give the party the power to make or break the rest of Mr Calderón's presidency. It also hopes to make gains in six gubernatorial elections to be held on the same day.

It might have expected to do even better. The American recession has dragged down Mexico's economy—GDP shrank by 5.9% in the first quarter compared to the previous one. But the polls suggest that Mexicans blame the gringos rather than Mr Calderón for this. The PAN has made its main election issue the president's popular—if not yet successful—battle with drug-trafficking gangs. Its campaign advertising reassures voters that, thanks to Mr Calderón, "drugs won't reach your kids" and encourages them to vote "to support the president." Nevertheless, the PAN could lose a score or more of its 206 lower-house seats.

Both the main parties will benefit from the disarray of the left. Andrés Manuel López Obrador, the presidential candidate of the Party of the Democratic Revolution (PRD) in 2006, alienated many Mexicans when he refused to accept his defeat. When his nominee lost a battle for the PRD's leadership last year, he formed a new alliance with rival leftist parties (without resigning from the PRD). All this squabbling means that the party will probably lose 30 or more of its 126 seats.

If the polls prove right, the balance of power in Mexico will have shifted towards the PRI but not massively so. Since he has lacked an overall majority in Congress, Mr Calderón has hitherto depended on the PRI's support to get his laws approved, and will do so even more. But the PRI may do better than the polls suggest. Turnout is traditionally low in mid-term elections in Mexico and may be lower still this time, since a network of middle-class activists is calling for spoiled votes in protest at the country's lack of direction.

That makes the election a test of party organisation. The PRI still has the strongest machine nationwide, a legacy of its decades in government. This matters even more this time because of a change in the electoral law in 2007 banning paid political advertising on television and radio, and preventing parties using their free airtime for negative campaigning.

Provided Mr Calderón does reasonably well in the election, he has a fresh chance to push through some of the structural reforms Mexico needs to reboot its economy. If the PRI manages to obtain an absolute majority, or if the PAN falls below the one-third of seats it needs to sustain a presidential veto, he would become a prisoner of his opponents. And Mexico's outlook would be even bleaker.

Conservation in Ecuador

Trees or oil

Jul 2nd 2009 | QUITO
From The Economist print edition

An ambitious scheme to save pristine forest starts to take shape



THOUGH half of Ecuador lies in the Amazon basin, its rainforest is shrinking faster than in neighbouring countries (by 1.67% a year). It has been ravaged by logging, poachers and oil extraction. Settlers have streamed in to carve out a precarious life. Over the past decade they have been joined by thousands of refugees fleeing violence in Colombia, as well as guerrillas and drug traffickers who inflict it. Native tribes have been uprooted, forced deeper into the forest or have disappeared.

The government of President Rafael Correa now wants help to keep pristine one of Ecuador's most important remaining jungle areas, in the Yasuní national park. In a corner of the park known as ITT (after the Ishpingo, Tambococha and Tiputini rivers) lies an oilfield which preliminary seismic studies show holds almost 846m barrels of oil, or around 20% of Ecuador's reserves. The ITT area is unusually biodiverse. It is thought to be home to several hundred tribesmen who shun the modern world and whose way of life is protected under a new constitution promoted by Mr Correa.

Oil companies, including Spain's Repsol and Chinese-owned Andes Petroleum, are already extracting about 59,000 barrels a day elsewhere in the Yasuní park. Repsol tightly controls access to its field, keeping out would-be colonists. Further east, Petroecuador, the state oil company and the country's worst polluter, is developing a block adjacent to ITT.

In 2007 when Mr Correa first mooted the idea that the world should pay Ecuador not to exploit the ITT oil this was widely dismissed as half-baked. Under the influence of a group of politicians from across the spectrum and environmentalists the idea is gaining flesh and credibility.

It now centres on issuing bonds for the value of the carbon emissions avoided by not burning the oil and by preserving the forest. These would be worth up to $5.2 billion at the current carbon price in the European emissions' market. The money would be lodged in a trust fund managed by international bodies such as the Inter-American Development Bank, and spent on alternative-energy projects in Ecuador. Bondholders would have a say in how the money is spent.

Last year Germany agreed to give €300,000 ($425,000) for feasibility studies, and last month reiterated its support. The scheme will go ahead once the first $350m is raised, says Roque Sevilla, a former mayor of Quito who is promoting it. The hope is that most of this money will come from European governments. If a future government in Ecuador opted to exploit the oil, it would have to repay the bondholders with interest, says Francisco Carrión, a former foreign minister who is another of the promoters.

He accepts that the main obstacle is Ecuador's poor reputation. In December the government defaulted on $3.2 billion in bonds—the third default in as many decades. As a result of Mr Correa's expansionist fiscal policy, Ecuador risks running out of foreign-exchange reserves, increasing the temptation to tap the oil. Nevertheless, the Yasuní-ITT initiative, as it is called, is now worth a closer look.

Indonesia's presidential election

More of the same

Jul 2nd 2009 | JAKARTA
From The Economist print edition

The world's biggest Muslim-majority democracy prepares to go to the polls again

AP



THERE are myriad reasons why Indonesia's president, Susilo Bambang Yudhoyono (often called SBY), ought to be worried as the days count down to the country's presidential election on July 8th. Only a quarter of the measures he promised in 2004 to improve the investment climate have been implemented. Desperately needed infrastructure development has been sluggish. Legal and judicial reforms have been patchy. Little progress has been made on improving labour-market regulation. The armed forces are so under-financed that aircraft crashes have become a monthly occurrence.

Meanwhile official poverty and unemployment rates, at 14.2% and 8.2% respectively, are much higher than he promised when he was first elected. Health-service delivery is widely considered woeful. Religious minorities believe they are more fiercely persecuted than five years ago. Then there is the minor matter of the world's worst recession in decades, which has taken its toll throughout South-East Asia's export-oriented economies.

And, to the dismay of many, Mr Yudhoyono (pictured centre, above) chose as his campaign slogan "Lanjutkan", which translates roughly as "More of the same". "Yes, we can!", it isn't.

Yet the former general with a PhD in agricultural economics appears to be anything but worried. The three-week campaign in the world's third-largest democracy looks more like a stroll to a coronation than a scrap for survival.

If the opinion polls are correct—and they were pretty accurate before April's legislative elections—Mr Yudhoyono is not only going to do far better than his two challengers, but is going to win outright with more than 50% of votes cast and more than 20% in half the country's 33 provinces (a requirement in vast Indonesia to ensure presidents have some support everywhere). This would eliminate the need for a second-round run-off in September.

Yudhoyono is coasting home

Polling, Indonesia's presidential election, %

Polling company	Date	Susilo Bambang Yudhoyono	Megawati Sukarnoputri	Jusuf Kalla	Don't know
Lembaga Survey Indonesia	21 June	67.0	16.0	9.0	8.0
	4 June	71.0	16.4	6.0	6.6
Lembaga Survey Nasional	9 June	62.5	14.2	11.4	11.9
	25 May	67.1	11.8	6.4	14.7
LP3ES	8 June	54.9	9.7	6.8	28.6
	29 April*	71.7	5.2	3.5	12.1

Sources: Lembaga Survey Indonesia; Lembaga Survey Nasional; LP3ES

*Excludes 7.6% who favoured other candidates

His standing as favourite has been a consequence of luck and skill. The timing of the rise and fall of the oil price has been fortuitous. Oil peaked a year ago. This was actually bad for Mr Yudhoyono's popularity in the short term, since he had to raise domestic fuel prices sharply in order to keep control of the government's ballooning oil-subsidy bill. Then, when oil prices fell, the president was able to cut prices of subsidised fuel, used by 90% of the population, three times.

But the initial cut in expensive domestic fuel subsidies made it easier for the government to afford to resurrect direct cash transfers to the 19.4m poorest families. Many cite the payments as their main reason for deciding to vote for Mr Yudhoyono, who never tires of reminding voters who introduced them.

The president has also been helped by his two challengers' insipid campaigning. Megawati Sukarnoputri, his predecessor (pictured above left), was a mediocre president and has failed to attract Yudhoyono waverers. Jusuf Kalla, the president's deputy (above right), cannot convincingly take more credit for the government's successes than the incumbent; he also suffers for having built up a family business empire in what are now seen as the bad old days. Even more than Mr Yudhoyono, they appear as relics of the authoritarian Suharto era. That is partly because of their running-mates. Mrs Megawati and Mr Kalla are both paired with Suharto-era generals. Mr Yudhoyono (who was one himself) is running with a respected former central bank governor and finance minister.

Despite many chances, none of the challengers has landed serious blows on Mr Yudhoyono, or even forced him on to the defensive for long. This has highlighted the fact that Indonesia's 11-year transition to democratic maturity has yet to reach the stage of peaceful disagreement. The media's inability to hold Mr Yudhoyono to account has accentuated that. No one wants to rock the boat too hard. The president has therefore been able to get away with a largely defensive campaign, making few promises and claiming—with some justification—that voting for his opponents would be a step backwards.

He looks unassailable

Mr Yudhoyono must also take some personal credit for his position. He has a graft-free reputation, not exactly a common feature of Indonesian politics. The war against endemic corruption has made great strides in the past five years, though this has more to do with the independent Anti-Corruption Commission than with Mr Yudhoyono himself. And while economic growth has slowed, it is still running at over 4% a year, while the neighbours are all in or teetering close to recession.

The government handled the crisis of late 2008 successfully, letting the rupiah weaken (it has since recovered), and borrowing to shore up revenues (it took out a $5.5bn standby loan co-ordinated by the World Bank in case stormy times returned, for instance). Most poor people, meanwhile, acknowledge what the government has done for them and are choosing to credit the president for it.

It is noticeable that Islam, and religion more broadly, has played only a small role in this election, though Indonesia is the world's most populous Muslim-majority nation. The Islamic-oriented parties performed poorly in April's legislative election. They are still struggling to work out why and to stop the rot.

If, as seems likely, Mr Yudhoyono becomes the first Indonesian president to be democratically re-elected, he might also end up—depending on the size of the turnout and margin—as the president with the largest number of direct votes in the world (that position is now held by Barack Obama, with 66.9m votes). The great question then would be how he might use what would be an unprecedented mandate.

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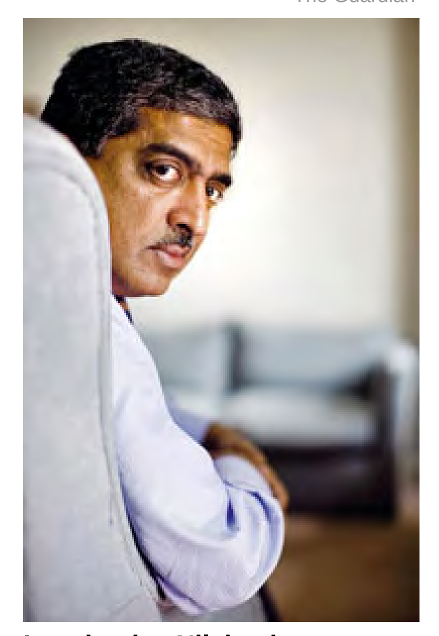
India's new identity card

Peering into their murky world

Jul 2nd 2009 | DELHI
From The Economist print edition

India hires a famous entrepreneur to shine a light on its invisible masses

The Guardian



Imaginative Nilekani

FOR Chanda, a middle-aged mother of two, moving to Delhi last year involved a trade-off. It brought her employment on the capital's roads, for which she earns 2,000 rupees ($41) a month; in her village in Madhya Pradesh (MP) she could find no work at all. But Chanda and her family lost the state benefits—cut-price wheat, rice and cooking-oil—they had been receiving because, though they are still eligible to receive alms, the BPL ("below-poverty line") card with which she claimed for them in MP is not recognised in Delhi. Nor is her voter-registration card, which allows her to vote only in her native village. Though all-too apparent, squatting under plastic sheeting on a Delhi pavement, she and her children are officially invisible.

Among India's roughly 100m internal migrants, there are many like them: without documentation to enforce their claims on the state or, alas, to protect themselves from its abuses. India recognises at least 20 proofs of identity, including birth certificates, caste certificates, tax codes, driving-licences and so on, but none universally. Hence a bold scheme to issue a new biometric identity card to the whole 1.2 billion population. It was announced in January, with much focus then on its potential for guarding against illegal immigrants and foreign terrorists, including the Pakistani sort that launched a commando attack on Mumbai in November. But it made bigger headlines on June 25th when Nandan Nilekani, co-founder of Infosys, one of India's biggest computer-services companies, was appointed—and given ministerial status—to run the scheme.

In a country known for its outstanding computer-services entrepreneurs and hidebound, lacklustre government, this was an exciting recruitment. "The two worlds have come together," says Mr Nilekani, a thoughtful man and best-selling author. His recent book, "Imagining India", includes an argument for just the sort of identity card that he must now, with a starting budget of 1 billion rupees, deliver.

In the language of his former profession, Mr Nilekani foresees his "Unique Identity Authority of India" as a vast server loaded with biometric and other details of every Indian, which will be accessed using the new identity card. The system would be used by central, state and local government bodies, so the cardholder's identity could be swiftly confirmed for a host of purposes—dispensing welfare benefits, issuing passports, updating land records and so forth.

By boosting technology and co-operation across the bureaucracy, this would seem to promise improvements throughout India's moribund public sector. It might also provide the standard form of identification for opening a bank account, a humdrum pleasure that two-thirds of Indian households have yet to enjoy. Daring to look further, Mr Nilekani imagines the system inspiring Indian service providers to develop new technologies to take fuller advantage of it. Thus, for example, it might help give Indians a wider range of financial services. "The technology we have available to us at our stage of development," he argues, "was not available to America and Europe [at the same stage in their development], and we have to take advantage of that."

This is heady stuff, especially given the coercive abilities of India's corrupt and territorial officials. Selling the scheme to central and state-level ministers and their minions, Mr Nilekani concedes, will be his first big test, and this explains why he requested the lofty rank conferred on his new office. Developing the right technology, and magnifying it to an India-size scale, will represent additional risks.

Nor, even if these obstacles are overcome, can the scheme be quite the administrative panacea that Indians crave. It is bound to get muddied; duplicate cards will be issued. But biometric checks should at

least make it relatively simple to detect such fraud—certainly compared with the rotten BPL system. While millions of paupers are, like Chanda and her children, deprived of their modest ration, some Indian states are believed to have more BPL cards in circulation than people.

Malaysia's racial-preference policy

Son versus sons

Jul 2nd 2009 | BANGKOK
From The Economist print edition

The prime minister reforms his father's economic policy

In 1971 Malaysia's second prime minister, Abdul Razak, began a policy of racial preferences for majority Malays and other "sons of the soil". The stated goals of the New Economic Policy (NEP) were to cut poverty and redistribute wealth, then largely in the hands of ethnic Chinese and non-Malaysians. On June 30th his son and the current prime minister, Najib Razak, took an axe to some of the privileges laid down by the father. He told foreign investors that Malaysia needed to overhaul its manufacturing-based economy to avoid falling into a "middle-income country trap". He proposed to reform the requirement that all listed companies must have 30% of their equity in Malay ownership. Limits on foreign stakes in fund management and stockbroking will be relaxed. Red tape will be cut.

For foreign investors, this is all welcome news. It should also help Malaysia's relations with trading partners such as America and the European Union, which have objected to the race-based rules. But the main audience is Malaysia's restless voters, who are leaning towards the opposition led by a former deputy prime minister, Anwar Ibrahim. Mr Anwar has vowed to dismantle the NEP, which is deeply unpopular among minority Indians and Chinese. Since the main beneficiaries of stock allocations are often cronies of the government, plenty of ordinary Malays are now also smelling a rat.

By junking the much-abused quotas, Mr Najib pulls the rug out from under his opponent. But he runs the risk of upsetting his base. The bigwigs in the ruling United Malay National Organisation (UMNO), which Mr Najib leads, like the playing field to be tilted in their favour. Their supporters may also worry about minorities becoming too assertive. In fact, though, Mr Najib's axe has fallen selectively. "Strategic" sectors such as energy and telecoms will keep the 30% rule, while Malays are still entitled to 12.5% of initial public offerings. Mr Najib also unveiled a new government agency that will invest in Malay firms in high-growth sectors.

Taken together, says Jeff Ooi, an opposition MP, the reforms are "baby steps" towards improving Malaysia's international competitiveness. Foreign investment may pick up. But the pro-Malay bias, he argues, has not really changed. Mr Najib still wants to lift Malay corporate ownership to the NEP target of 30%, from a claimed 19% now. Experts say it is much higher and that it suits UMNO to pretend otherwise. Calculating the correct share is complicated by "Ali Baba" companies, in which Malay equity holders subcontract the work to Chinese firms.

It is too much to expect Mr Najib to demolish his father's policy in one go. But his apparent willingness to confront vested interests in his party bodes well for his leadership. His predecessor, Abdullah Badawi, left office in April without producing his promised reforms. In his speech, Mr Najib said there is no point in retaining privileges at the expense of economic growth. "We can only achieve our social equity goals by expanding the pie," he concluded. Investors can only hope that he is right.

Japanese politics

A kick up the Aso

Jul 2nd 2009 | TOKYO
From The Economist print edition

The ruling LDP plays a sloppy endgame

Illustration by Peter Schrank



PANIC is palpable among legislators of the ruling Liberal Democratic Party (LDP). Japan is on the verge of an historic change of government. A general election for the Diet (parliament) must be called by mid-September, after which power is expected to pass to the decade-old opposition, the Democratic Party of Japan (DPJ), after more than 50 years of almost uninterrupted LDP rule.

But the ruling party is not going gracefully. A gaggle of younger LDP parliamentarians is agitating to bring forward the selection of party president set for September in a clumsy attempt to replace the prime minister, Taro Aso, before the election. In recent days a few party elders have also called for him to step aside. Talk of ousting Mr Aso makes the LDP look desperate: he would be the fourth prime minister to quit in as many years.

To quell the rebellious rabble and offer fresher faces to voters, Mr Aso considered a big cabinet reshuffle (shades of Britain's Gordon Brown). On July 1st, however, he chose a much more modest course, filling two posts that had previously been handled by ministers who had taken on multiple roles following the resignations of other cabinet members.

The cosmetic nature of the change reinforces the perception that the LDP is flailing. Dissatisfaction has been brewing for a decade and a half, though a plethora of hapless opposition parties has failed to do more than briefly interrupt LDP rule (for an 11-month stint in 1993-94). One former prime minister, Junichiro Koizumi, even won his mandate in 2001-06 after vowing to "destroy" his own party.

In the end, it will probably be Mr Aso's mediocre performance that administers the coup de grace. In opinion polls in mid June, the prime minister's popularity sank below 20% after enjoying a brief lift following a fund-raising scandal that forced the DPJ's leader to resign. Now, new fund-raising scandals threaten both parties. Two members of Mr Aso's cabinet have been accused of accepting illegal donations. And the DPJ's new leader, Yukio Hatoyama, has had to apologise after it was revealed that his political organisation listed deceased and fictitious people as donors. In polls, voters prefer the DPJ to the LDP by almost two to one. But around half the public prefers neither party.

One bellwether for the national election are municipal contests, in particular the Tokyo assembly election to be held on July 12th. This is especially important because the assembly is the power base of the LDP's coalition partner, New Komeito, which gives the party its majority. The DPJ has won a string of local contests in recent weeks, with significantly increased turnouts. Where national politicians are reviled, a new breed of local ones has captivated voters.

It is hardly surprising that the electorate is turning against the governing party. Quite apart from public displeasure at the entire political class, Japan is expected to be the hardest hit of rich economies this year: its GDP is forecast to contract by 6%, around twice the level of America or Britain. True, the Bank of Japan's Tankan survey of sentiment among large manufacturers showed the biggest improvement in two and a half years on July 1st—to minus 48 from a record minus 58 in March. Yet the negative figures suggest economic recovery will be slow and difficult. The LDP's electoral prospects are not much rosier.

Treason in cyberspace

Jul 2nd 2009 | BANGKOK
From The Economist print edition

The battle over the royal family between government and opposition goes online

Panos



And don't you deny it

ON YOUTUBE, he was "thaiman 8", a prolific poster of crude videos that mocked Thailand's royal family. These days Suwicha Thakhor goes by another identity: inmate in Bangkok's Khlong Prem prison. In April he was sentenced to ten years in jail after pleading guilty to *lèse majesté*, the crime of defaming or threatening the Thai crown. Since 2005 this century-old law has enjoyed a renaissance, netting politicians, scholars, activists and an Australian author. Recently, it seems to have got more coercive.

Daranee Charnchoengsilpakul was arrested in 2008 after a blistering anti-royal public tirade. She went on trial last week and the judge ordered the case to be heard behind closed doors on national-security grounds—a ruling that would conveniently bar the foreign press. Ms Daranee and her lawyer cried foul. An appeal is pending.

The scope of investigations under the law is widening. This week police began inquiries into whether the board of the Foreign Correspondents' Club of Thailand is guilty of *lèse majesté*. Equally disturbing is a new snitch scheme set up by the justice ministry. The scheme, claims a free-speech activist, is a way of monitoring social-networking sites. In May the prime minister, Abhisit Vejjajiva, signed up as the first volunteer. The goal seems to be to defend the royal family from criticism.

Thailand, unlike China, claims to be a democracy. But as in China, cyberspace has become a battleground between free speech and censorship. Online speech has been freer than Thailand's supine news media. But censors are working overtime. Since March 2008 the Ministry of Information and Communications Technology (MICT) has blocked 8,300 website pages on *lèse majesté* grounds. Thailand's police have jammed another 32,500 pages for various offences. In 2007, YouTube was blocked for several months.

Cyberspace is being subjected not only to *lèse majesté* constraints but to other laws. Mr Suwicha fell foul of one. He was charged under Thailand's 2007 Computer Crime Act, which makes it an offence to import computer data that harm national security. In the eyes of Thai authorities, rude anti-royal videos fall into that category. Mr Suwicha is the first person to be convicted under a law that carries a five-year jail term and was passed by a military-appointed legislature. He is unlikely to be the last. Police have arrested dozens of internet users who posted comments on web boards. Some face criminal charges.

The authorities are also going after webmasters for failing to delete offensive posts promptly enough. One, Chiranuch Premchaiporn, who runs Prachatai.com, a news website, was charged in April because her site carried a comment by one user which allegedly excoriated Queen Sirikit. Ms Chiranuch insists that she deleted the post when asked to by MICT. But Aree Jiworarak, an official at the ministry, says Ms Chiranuch should have spotted the post herself and is "responsible for what happens". To her distress, Ms Chiranuch was forced to disclose private data that led police to the user, a Thai woman with the online name "Bento", who was arrested and charged. Ms Chiranuch faces multiple counts that could, potentially, send

her away for 50 years.

Crime or politics?

The political backdrop to this witch hunt is well known. Since a coup in 2006 Thailand has been torn between supporters of the ousted prime minister, Thaksin Shinawatra, and his conservative opponents in the armed forces, judiciary and, many assume, the palace. In December a coalition led by Mr Abhisit took power in the wake of anti-Thaksin protests by yellow-clad royalists known as the People's Alliance for Democracy (PAD). A red-coloured protest movement allied to Mr Thaksin failed in April to force out Mr Abhisit. He has claimed that there is a conspiracy to undermine "the institution", as the crown is known. His backers point the finger at the irascible Mr Thaksin, who denies disloyalty to the throne while cocking a snook at "aristocratic" Thai government.

But the efforts of self-proclaimed royalists are arguably doing as much harm to the institution as criticism by their opponents. The justice minister, Pirapan Salirathavibhaga, for instance, has declared that his highest priority is the protection of the monarchy. So an elite law-enforcement agency in his ministry, which is supposed to take on drug kingpins and other crooks, is busy chasing lowly bloggers.

By persecuting Thais who give vent online, these moral guardians may be adding to the anger against Bangkok's elite and, perhaps, fanning the flames of republicanism. Their zeal certainly undercuts Mr Abhisit's feeble efforts to unite a polarised nation. Many observers conclude that the crown must be behind the crackdown. They think the royal family wants to keep a lid on frank discussion, at least until the 81-year-old King Bhumibol hands over to his likely successor, the unpopular crown prince, Maha Vajiralongkorn. Not so, insists a source in the palace, who blames an overzealous government for the spurt of arrests. King Bhumibol himself said in 2005 that he was not above criticism. He has also pardoned *lèse majesté* convicts, including Harry Nicolaides, an Australian author, in February.

Even in China, it is hard to control the internet (this week, the country delayed plans to put internet filtering software into every computer). And compared with China's sophisticated controls, Thai censorship is Firewall 101. It uses keyword searches to turn up suspect websites. Wily netizens will no doubt stay a step ahead of the censors, using proxies and other tools, as they do in China and Myanmar. Meanwhile, the government's efforts to protect the good name of the king are not only damaging democracy but may even rebound upon the royal reputation.

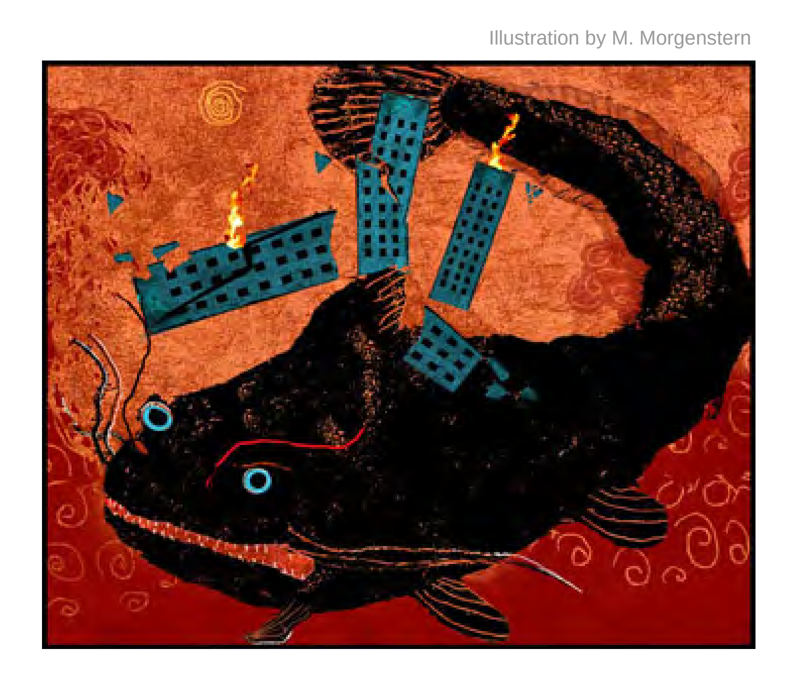
Banyan

When the catfish stirs

Jul 2nd 2009
From The Economist print edition

Earthquakes, and the preparations for them, are metaphors for Japan's malaise

Illustration by M. Morgenstern



A CAPRICIOUS, mythical catfish lies beneath the Japanese archipelago. Usually the Shinto god of the earth keeps the brute's head pinned down with a granite keystone. But when Kashima drops his guard, the thrashings of the grotesque fish convulse the earth.

Japan is extraordinarily prone to earthquakes, accounting for nearly a fifth of the world's supply of them. No city, not even Los Angeles, surpasses Tokyo for seismic action. With tsunamis and typhoons too, an acceptance of natural disasters is said to be hard-wired into the Japanese psyche.

Tokyo sits near two fault lines, not one. South-west of the city, the Philippine Sea tectonic plate dives down under the Eurasian continental plate, bending the Eurasian plate down with it. From time to time, parts of that plate spring back, like a ruler bent over the edge of a desk and let go. The 8.3-magnitude Great Kanto earthquake in 1923 originated in this way, killing 140,000 and causing scenes of devastation in Tokyo and the great port city of Yokohama, even nearer the epicentre.

But potentially more catastrophic is the kind of earthquake that might well up from the depths immediately below the capital. There, not just the Philippine Sea plate but the Pacific plate descends under the Eurasian plate on which Tokyo sits. New work suggests that a chunk 60 miles long and 15 miles thick appears to have broken off and got lodged between the two ocean slabs like a deer swallowed by a python. Its convulsions are thought to be the source of deep-thrust earthquakes throughout Tokyo's history, the last one in 1855. While other quakes ripple towards Tokyo like a rug being flicked, this kind pumps the whole city violently up and down, then side to side.

The chances of a magnitude-seven quake are put at 70% in the next 30 years. A 7.3 shock beneath Tokyo, it is estimated, would cause $1 trillion of damage, which would be easily the most expensive calamity in history.

Historical accident put one of the world's biggest cities (23m) on such dangerous ground. The victor of a late 16th-century civil war was the shogun of Edo, which became Tokyo, the imperial capital. Even today the population of greater Tokyo grows slightly while Japan's shrinks. More than six decades have passed since the last, destructive quake. Tremors every few weeks set pictures swinging and bookshelves rattling.

But regularity lulls more than it alarms. Is Tokyo becoming complacent about the restless catfish in its depths?

The metropolitan government insists not. Annual disaster drills are conducted. Building standards have been tightened. Roads have been widened to serve as firebreaks and emergency routes. Dense residential areas have been cleared in favour of high-rise developments. The long-range planning on which Japan once prided itself is still in evidence.

Yet the building standards are not retrospective. The drills appear mainly for form's sake, a fun day out. Disaster education, mainly in the form of jolly cartoons, seems designed to play down the dangers. One third of Tokyoites polled some years ago said they did not even know an earthquake-warning system existed, and the government is loth to test it for fear of causing alarm. Exhortations for action—huddle together under a table during a powerful quake—might be for talismanic effect.

Japan has long had a powerful construction lobby and a can-do attitude to building. But in retrospect many projects look hubristic. Huge urban developments have been built along Tokyo Bay, many on reclaimed land. Yet the soft alluvial sediment of Tokyo's low-lying areas, it is now understood, is vulnerable to liquefaction, in which violent movement turns the soil to quicksand. Tokyo ran up lots of tall buildings, which were thought to be safer than low ones because, though they sway alarmingly, they do not snap. But on soft soils, vibrations from long-period seismic waves are amplified, possibly exacerbating the swaying of skyscrapers. In truth, engineers' calculations have not been tested. Meanwhile the graft endemic to Japan's construction industry more or less guarantees that corners have been cut.

There'll be changes made

Tokyo's quake of 1855 came just after the arrival of Commodore Matthew Perry and his "black ships" which forced Japan to open to the world. The two traumas were conflated. The 1923 quake and its economic consequences hastened military rule and war. The coming quake may reverberate politically, too, particularly affecting the public paternalism that prevails in Tokyo's approach to disaster management as in so much else.

A disaster would expose the government's known shortcomings: its tendency to stress duty over flexibility; the squabbling and rivalry of its different departments; its lack of preparation. A recent earthquake drill in Shinjuku railway station, where up to 200,000 commuters might head after an earthquake in the hope of getting home, sounded a warning. It was, says a senior Tokyo official, "a perfect-sounding drill, in a perfect world, but still a failure." The problem was the absence of government staff (they will be off dealing with the graver emergencies). Nobody could agree whether they should lead or follow.

If that sounds like a metaphor for Japan's current malaise, then perhaps there is a silver lining. Japan's paternalism, and the political apathy of voters that is its mirror image, has survived the cold war and an economic boom and bust. It may even survive the coming election, in which the Liberal Democratic Party may fall from power without the Democratic Party of Japan offering a clear alternative. No one could possibly wish a catastrophe on Tokyo, but thinking about it provides a clarity in which much more is demanded of Japan's political leaders.

Economist.com/blogs/banyan

Iran's disputed presidential election

A hollow victory

Jul 2nd 2009
From The Economist print edition

Mahmoud Ahmadinejad keeps power but loses legitimacy, particularly among the middle class

AP



THE case is closed. The landslide claimed by Mahmoud Ahmadinejad in the June 12th presidential election was real, says Iran's government, and anyone who doesn't like it can lump it or, indeed, risk going to jail. After weeks of unrest, the state has reasserted its power. Heavy policing has blunted public protests, while a more targeted campaign of arrests, intimidation and controls on communications has hamstrung attempts to organise and sustain opposition. But with accusations of foul play still being voiced, even within the religious establishment that supports the Islamic Republic, Iran's hardliners will struggle to re-establish legitimacy.

The Guardian Council, an appointed body dominated by clerics allied to Iran's supreme leader, Ayatollah Ali Khamenei, was in charge of investigating allegations of electoral fraud. Considering that it has a record of barring reformist candidates and that its chairman publicly endorsed the arch-conservative Mr Ahmadinejad before the ballot, the result was preordained: the council announced on June 29th that its researches, including a partial recount, had produced no sign of wrongdoing, so closing the last legal channel to contest the outcome. Pro-regime news outlets even suggested that the revised tally showed gains for Mr Ahmadinejad. The president declared not just a personal triumph but the defeat of an enemy plot to overthrow the regime.

Yet his three rival candidates have remained defiant, insisting that Mr Ahmadinejad's claimed 63% victory could have been secured only by fraud. They insisted that the election either be annulled or subjected to a full, impartial investigation.

Mir Hosein Mousavi, the runner-up to Mr Ahmadinejad, and another reformist candidate, Mehdi Karroubi, said the government was illegitimate. Mr Mousavi asked: "How can people trust a regime which imprisons its friends, colleagues and children?" Websites close to him called for peaceful protests to continue, including a possible general strike. Even close associates of the sole conservative challenger, Mohsen Rezai, who has lately muted his criticism in deference to the supreme leader, continued to assert that he had been cheated.

But such displays of defiance belie a widening sense of despair among Mr Ahmadinejad's opponents. A statement from an influential group of reformist clerics hinted at the change in mood. While reserving the right to protest, it said that Iranians had already paid a high price for speaking out and gave warning that escalating tensions and street protests "are not the solution". Powerful reformist allies, including the former presidents Muhammad Khatami and Hashemi Rafsanjani, have taken to reasserting their loyalty to the Islamic Republic while working behind the scenes to negotiate a compromise.

The toll from the weeks of post-election unrest, which at its peak brought as many as 2m protesters onto Tehran's streets, includes perhaps 20 deaths, hundreds of injuries and extensive property damage. Much of this was perpetrated by government agents, judging from extensive footage captured in amateur videos and posted on the internet.

The widest sweep of suspected regime opponents since the 1980s has seen hundreds of ordinary citizens hauled off to jail, along with prominent journalists, human rights advocates and dozens of reformist party leaders, many of whom served as senior officials in previous administrations. In what appears to be the beginning of a full-scale purge, reformist sympathisers in Iran's oil ministry have been replaced by hardliners. Even those with no apparent involvement in politics, such as Bijan Khajehpour, a well-known business consultant, have been detained.

Chillingly, the state-controlled media have taken to airing purported confessions from some of these prisoners. The interior minister also claims to have uncovered a conspiracy whereby armed saboteurs pretended to be members of the *baseej*, a vigilante force of zealots which has been widely accused of brutality.

Hardliners are trying to present the unrest as the result of foreign intrigue, notably by Britain, the old colonial meddler. Britain and Iran have engaged in tit-for-tat expulsions of diplomats. Local staff of the British Embassy in Tehran were rounded up (and most then released). Iran's interior minister claims he has footage showing them taking part in anti-government demonstrations. Some pro-regime loyalists claim that the fatal shooting of Neda Agha Soltan, captured on video by bystanders during a demonstration, was staged by agents in the pay of the BBC, whose Persian television channel has drawn the regime's ire.

Hardline clerics say that in future protests will be viewed as *haraba*, a crime of banditry for which the punishment is execution. Yet the shrillness of such threats, and the violence of the crackdown, have only strengthened the impression that Iran has experienced something like a coup d'état by hardliners, not by the reformists who are accused of trying to mount one. With the bulk of Iran's middle class now alienated from its leadership, and the Islamic Republic's prestige sullied before the world, this is not much of a victory for Mr Ahmadinejad to savour.

Royalist politics in Morocco

The king's friend

Jul 2nd 2009
From The Economist print edition

A new leader emerges, but how credible will he be?

AFP



Arise, Fouad

A NEW political force is emerging in Moroccan politics. The Authenticity and Modernity Party, known by its French acronym, PAM, with a centrist non-ideological platform open to all comers, has been in existence for less than a year. Yet it already seems destined to win the general election in 2012. In its electoral debut in last month's municipal poll, PAM won the ballot with 22% of the vote. Yet for all its success, the ascent towards the prime ministership of its founder, Fouad Ali El Himma (pictured), is the chronicle of a political elevation foretold.

In 2007 Mr El Himma resigned from his job as deputy interior minister and announced his intention to run as an independent in the parliamentary election that year. Where a few saw a fall from royal grace— he was known to be a close political adviser to King Muhammad VI—others sensed the beginning of a reconfiguration of monarchist parties.

Mr El Himma founded an anti-Islamist group, the Movement of All Democrats, which he then used as a springboard to create PAM. He recruited extensively from what is known as "administrative parties"—electoral machines dating to the time of the monarch's late father, Hassan II, and composed mostly of provincial notables. He also wooed bright young leaders of civil society. PAM drew most of its MPs from rival parties, prompting these to complain that it was promoting "political transhumance". This is forbidden by the electoral code, which bans elected officials from changing affiliation while in office, but the law has thus far been enforced selectively.

In response, on May 29th, on the eve of the municipal elections, PAM withdrew support from the coalition led by the prime minister, Abbas El Fassi, leaving the government in a minority. King Muhammad reiterated his support for Mr El Fassi, and the government will not fall unless there is a vote of no-confidence. But the move is seen as heralding the formation of a new government led by PAM. The party's rise, wrapping old political networks in new reformist rhetoric, highlights the enduring strength of the *makhzen*, the informal political-security-economic groupings that dominate Moroccan politics.

Mr El Himma has left the official leadership of PAM to Muhammad Sheikh Biadillah, a former health minister from the disputed Western Sahara province; he is more comfortable working in the background. The Moroccan press refers to Mr El Himma as "the king's friend". Like all the most important royal advisers, he is a former classmate of King Muhammad, and his success depends largely on having (or being perceived as having) the monarch's ear.

That is an uncertain advantage. One royal confidant says "the king likes Fouad, but does not want him to become another Driss Basri"—a reference to the late ex-minister of the interior who harshly repressed opponents of Hassan II. Tellingly, within three months of ascending the throne King Muhammad sent his father's right-hand man into exile. If Mr El Himma rises too high, he may yet find himself on the way out.

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Fighting AIDS in Sudan

Imams, tea ladies and condoms

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From The Economist print edition

A killer of another sort stalks one of Africa's most conflict-riven countries



FOR six years, Najun Eldin Muhammad Ahmed has been living with HIV. But he is an unusual man. In the pious and conservative Muslim north of Sudan, he not only admits it, but campaigns actively to raise awareness of the virus. He has corralled 42 fellow sufferers in Port Sudan, on the Red Sea, to form one of the country's most active AIDS-support groups. Mr Ahmed willingly concedes that his group represents only a tiny fraction of those infected with HIV, the AIDS-causing virus, in a city of almost half a million people.

On top of Sudan's myriad other problems, such as the bloody war in Darfur, the country also has a full-blown epidemic of HIV on its hands. Reliable figures on any subject are hard to come by in Sudan, let alone one as sensitive as this. Nonetheless, enough research has been done to confirm some of the worst fears about the spread of HIV in the country. The last big study in 2003 revealed a prevalence rate of 1.6%, but experts say that is probably now approaching 3%. The rate in neighbouring Egypt, by contrast, is just 0.1%; anything over 1% is counted by the World Health Organisation as an epidemic.

In 2007, 31,600 people died of AIDS in the Arab region; of those 80% died in Sudan. For now, Sudan has a lower rate of infection than several other countries in sub-Saharan Africa but, given the right conditions, HIV can suddenly spread out of control. And doctors worry that Sudan has those conditions in abundance: it has a high rate of sexually-transmitted diseases caused by poverty and internal migration, as well as displacement caused by war.

But it is sheer ignorance that contributes most to the spread of HIV and AIDS. In a study of policemen in Khartoum state in 2005, only 1.9% of those interviewed knew that a condom could protect them against HIV. In a survey of the country's imams, 27.5% thought that mosquitoes could transmit HIV. While many of them had heard of condoms, only 8.5% "mentioned them as a tool of prevention".

To its credit, despite a widespread public desire to ignore or downplay the epidemic, the Islamist government of President Omar Bashir has committed itself to an anti-AIDS campaign, setting up the Sudan National AIDS Control Programme. However, the government has put almost no money into the effort; it does, after all, spend over 70% of the national budget just on soldiers and weapons.

Instead, the government relies on international agencies such as the United Nations Development Programme and the Global Fund. Together, they are doing innovative work in the Muslim north of the country, enlisting the help of imams and even of women religious leaders, the daias. The hope is that they can persuade conservative-minded Muslims to change their lifestyles and attitudes.

Take the state of Kassala, on the border with Ethiopia and Eritrea. Partly because Kassala is a trans-shipment point between those two countries and Sudan, the state has one of the biggest HIV problems in the country. So the state health ministry has recruited 13 daias to educate women about the cause and spread of AIDS during the female equivalent of the all-male Friday prayers. One of these daias, Alawiya Libeb Othman, concedes that AIDS carries a huge "stigma", but she argues that it is her job to "get people to accept that people with AIDS should not be ostracised and that AIDS sufferers have equal rights". She quotes a verse from the Koran: "Never despair of God's mercy."

Several imams in Kassala issue messages about HIV in their Friday sermons, noting that the virus is spread not just by immoral sexual conduct but also by tainted blood. Bravely, they will also discuss issues such as prostitution—not least the "tea ladies" that sell drinks (and other services) to lorry drivers—and homosexuality. This apparent tolerance, a consequence of Sudan's strain of Sufism, has its limits. The imams discourage easy access to condoms for fear of promoting promiscuity.

Despite the anti-AIDS campaign, ignorance remains profound. At a training course for imams, one confessed that he had assumed that there were just one or two cases of the disease in Sudan and that it was not fatal. It might take a generation, and a lot more government money, to shift such perceptions. But without a more concerted effort, HIV and AIDS could end up threatening more lives than the country's calamitous wars.

Meeting Somalia's Shabab

The next jihad

Jul 2nd 2009 | BUALE AND DUSAMAREB
From The Economist print edition

Fear and beheadings in the heartland of the militants



THE Juba river region, in Somalia, is hard country. Women are regularly eaten by crocodiles while fetching dirty water. The sandy farmland is either in drought or flooded. And the militants known as the Shabab, who rule the area, exact brutal justice. Your correspondent had to turn back from the town of Wajid (see map) this week because, within, a man was being beheaded. A day later, a clan leader was shot dead. As *The Economist* went to press, three more were to be beheaded in Wajid, and two more had suffered the same fate in a nearby village.

All were suspected of being "collaborators" with the internationally recognised, but largely powerless, transition government in Mogadishu that is protected by a small African peacekeeping force. It is led by Sharif Ahmed, a moderate Islamist, who once headed the Islamic Courts Union. This had imposed a tenuous calm in the city, but was swept from power by Ethiopian forces in 2006 because its erstwhile allies in the Shabab, or "Youth", had ties with al-Qaeda. If anything, the intervention strengthened the Shabab and hardened their link with global jihadism—not least because of an influx of foreign fighters who see Somalia as the next battleground for holy war.

The Shabab now control most of south and central Somalia, and much of Mogadishu. Western security sources worry they could stage attacks outside the country, of the kind that destroyed the American embassies in Kenya and Tanzania in 1998.

The Shabab, for their part, have nothing but contempt for President Ahmed. "Even you [an infidel] are closer to us than he is," one stern-looking Shabab commander tells your correspondent. "He is far, far from us, because he has sold out his religion." Dressed in jeans and sandals, and sporting a wispy beard, the commander asks not to be identified; even speaking to an unbeliever can invite retribution. Western security sources say many foreign militants are in the Juba valley. And the commander is happy to have them. "Colour makes no difference," he says, "All Muslims are the same. They are welcome."

There is a streak of pragmatism among the Shabab that is distinct from al-Qaeda. The Shabab guarantee the safety of the food convoys of the United Nations' World Food Programme (WFP). That said, there is an air of fear in Shabab-ruled areas such as Buale. Checkpoints are everywhere. Elders seem to be losing authority; they stick to resolving disputes over land and marriage. Residents are for the most part reluctant to talk. One tells the story of a 15-year-old boy who returned home to the Juba river after fighting with a ferocious Shabab unit in Mogadishu. When his mother pleaded with him not to return to the fighting, he threatened to kill her on the spot.

Not all those who bear arms in the name of Islam support the Shabab. Several hundred kilometres north-east of Buale, in the town of Dusamareb, Sheikh Omar Sharif Muhammad, a Sufi religious leader, has mobilised fighters to "liberate" Mogadishu from the Shabab. On July 1st, Somalia's Independence Day, a local crowd gathered to sing patriotic songs and raise the national flag, a white star on an azure background—a rare sight for a country without a working government since 1991. Some of the men from his movement, Ahlu Sunna Waljama, had shiny new Kalashnikovs; Sheikh Omar said they were not gifts from Ethiopia or America, both of which want to counter the backing given to the Shabab by Eritrea and private Arab donors.

Sheikh Omar's men do not have the strength to march on Mogadishu any time soon, but in several

recent battles they have halted the northward advance of the Shabab. They claim to have killed all manner of foreign fighters, and to have recently intercepted two Canadians of Somali extraction sent out as suicide-bombers.

Security in the Galgadud, the desert region controlled by the militia, has improved. But the humanitarian situation is dire. WFP says 90% of the 400,000 people in the area need food aid to survive. The failure of the Gu rains, which fall between April and June, promises greater misery. Matters are made worse by the arrival of 60,000 people fleeing Mogadishu.

Some of the refugees are gathered in a compound near Sheikh Omar’s base, among them Muhammad Hassey, who says he has moved house ten times over the years to escape fighting. He finally left Mogadishu when his two brothers and two sisters were killed by a mortar shell. Kadijo Hassan, an elderly lady, interrupts. “Mogadishu is unbelievable,” she says. “It is war. Everyone is crying there.”

Chinese aid to Africa

Spreading its bets, and its gold

Jul 2nd 2009 | JOHANNESBURG
From The Economist print edition

Beijing finds new friends in Zimbabwe

CHINA has had friendly ties with Robert Mugabe, Zimbabwe's president, since his days as a Maoist guerrilla leader fighting white rule in the 1970s. Decades later, as he suppressed the opposition and ruined his country, China helped to protect him from sanctions at the United Nations, sold him weapons and even built his palace. But its favour, never unconditional, seems to be shifting.

On June 30th it was Mr Mugabe's biggest foe, Morgan Tsvangirai—with whom he has awkwardly shared power in a unity government since February—who announced that China had offered Zimbabwe $950m in loans. This is well in excess of the nearly $500m Mr Tsvangirai said he had obtained in pledges of various kinds during a tour of Western capitals.

There is much uncertainty about all of these offers of money, not least the extent to which they are a repackaging of existing pledges and what conditions have been attached. China, for its part, said the loans were still under discussion.

Real or not, for now the announcements allow Mr Tsvangirai, currently serving as prime minister under Mr Mugabe, to score several political points. Firstly, they counter taunts by Mr Mugabe's Zanu-PF party that Mr Tsvangirai and his Movement for Democratic Change (MDC) had not secured any fresh funds from their Western friends; the government could not pay employees, "not even the ministers, not the president", Mr Mugabe said.

Secondly, Mr Tsvangirai said even more money would be forthcoming once Zimbabwe made a full transition to democracy—an attack on Mr Mugabe for allegedly using his security forces to undermine the MDC. Finally, and most satisfyingly, Mr Tsvangirai was able to imply he had the backing of China, the big new power in African matters. He made his announcement just as members of Zanu-PF were visiting Asian countries to drum up support.

China's intentions are far from clear. Nobody seems to know, for example, how much, if any, of the pledged $950m is coming from the government and how much from the private sector. Which ministry's projects will they finance? And what are the conditions for repayment? Zimbabwe already owes more than $4 billion to international financial institutions. That is why the IMF and World Bank are refusing to grant it additional credit.

That said, Western countries have hardly abandoned Zimbabwe. They are providing it with nearly $1 billion in humanitarian aid this year, including $100m from Britain and around $250m from America. Nearly all of it is being channelled through UN agencies and NGOs to prevent it falling into Zanu-PF's rapacious hands. Donors are also beginning to find ways of funding projects backed by reformist MDC ministers by channelling the money through specially audited bank accounts.

Mr Tsvangirai says Zimbabwe needs $8.5 billion to kick-start its once-flourishing economy. He is clearly not fussy about where it comes from. The new government was not limited to a "look West" or "look East" policy, he said. It wanted to engage with all countries.

China too is hedging its bets between Mr Mugabe and Mr Tsvangirai. In its hunger for Africa's vast natural resources, China has become the continent's most important trading partner after America; trade between Africa and China has surged from just over $6.5 billion in 1999 to $107 billion in 2008. In offering Zimbabwe such a huge dollop of credit, China is signalling that it is in the country to stay.

South Africa and football's World Cup

On goal for 2010

Jul 2nd 2009 | JOHANNESBURG
From The Economist print edition

The doubters are so far being proved wrong

Getty Images



A great header

WHEN, in 2004, South Africa was chosen to be the first African country to host football's World Cup many fans around the world were doubtful. South Africa would mismanage it, they said. It would be a commercial flop. They mooted Australia as an alternative should South Africa's organisers fail to get their act together. Five years on, the doubts have diminished as new stadiums rise up across the country. Indeed, next year's tournament may turn out to be the most profitable yet, thanks to the sale of broadcasting rights.

As a dress rehearsal for the big event, South Africa hosted the Confederations Cup, featuring the champions of the world's six regional football federations, plus Italy (the current holder of the World Cup) and South Africa (the host). It was won by Brazil by 3-2 in a thrilling final against the United States on June 28th.

Most of the opening matches were played in stadiums barely half-full, but the tournament took off, especially after ticket prices were reduced. Best of all, South Africa's own team, known as "Bafana Bafana", though ranked only 72nd in the world, reached the semi-final, cheered on by exuberant crowds blowing the *vuvuzela*, a metre-long plastic horn that some foreigners want to ban because, they say, it distracts players and sounds like flatulent elephants.

Traditionally regarded as a "black" sport in South Africa, with whites preferring rugby and cricket, football has long suffered from a lack of investment. But this is changing. South Africa's selection to host next year's World Cup has at last brought big money into the game.

About 12 billion rand ($1.48 billion) is being spent on nine stadiums (four of them used for the Confederations Cup), with billions more to build or improve roads and airports. And the country is to get its first high-speed railway, linking the main airport with Pretoria, the capital, and Johannesburg. Predictably, this had led to grumbles that such vast sums would have been better spent on helping the poor.

But most South Africans are proud that their country is hosting so big an event, hoping it will polish its image abroad and help unite its people, as winning the rugby World Cup on home soil did in 1995. In any case, the spending should provide a welcome fiscal boost as the country experiences its first recession in 17 years. One study reckons 500,000 cup-related jobs will be created. The biggest worry remains crime. In a country with some 50 murders and 99 reported rapes every day, the extra 41,000 police that will be deployed for the event will have more to worry about than the noisy blast of the *vuvuzela*.

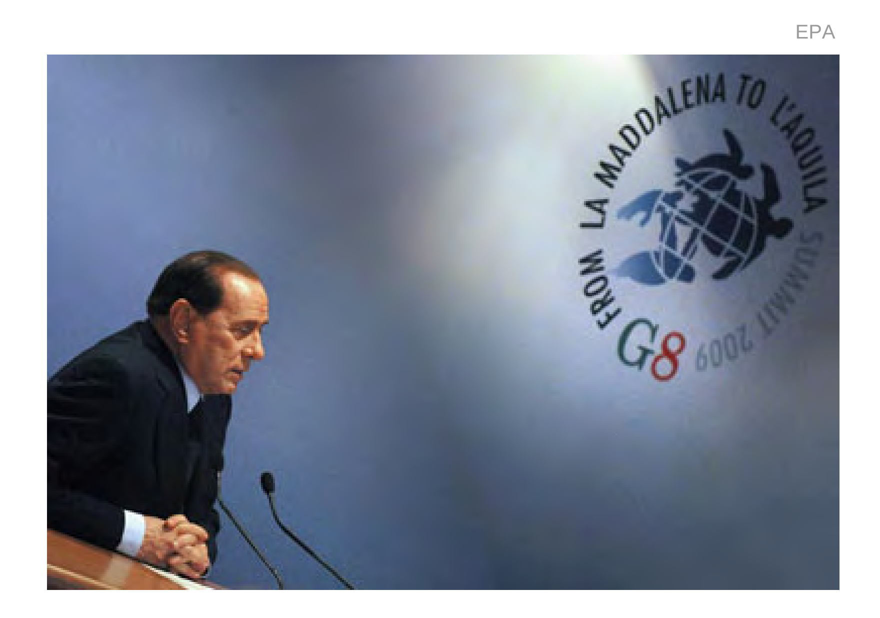
Italy and the G8 summit

A cavalier preparing to host the world

Jul 2nd 2009 | ROME
From The Economist print edition

The host of the G8 summit, Silvio Berlusconi, faces many lurid scandals at home. But the biggest should be his refusal to accept the extent of Italy's economic woes

EPA



WHEN the leaders of the world's largest economies meet on July 8th near the Italian city of L'Aquila for this year's G8 summit, they will find themselves in an apposite setting. Three months ago L'Aquila was hit by an earthquake that left 300 people dead and much of the city centre in ruins. The area is still experiencing powerful aftershocks: on June 22nd there was yet another one.

It might be imagined that none of the assembled leaders would deny that their economies have also been shaken to their foundations. But one does: the host. Italy's prime minister, Silvio Berlusconi, has from the outset insisted that in Italy the recession will be neither as severe nor as prolonged as elsewhere.

At first, this view had some credibility. With a banking system leery of derivatives and relatively isolated from the rest of the world, Italy did not suffer disaster of the sort that brought financial institutions crashing to the ground in America and Britain. But analysts have since given progressively greater weight to other considerations. The Italian economy is highly dependent on exports (partly because of weak domestic demand) and so exposed to a decline in world trade. What is more, the public debt is huge (worth well over 100% of GDP), so the government has little scope to copy others in borrowing for costly stimulus measures. An "anti-crisis" package unveiled by Mr Berlusconi on June 26th was unhelpfully modest: its main provision was a 12-month, 50% tax break on reinvested profits.

In recent weeks, respected organisations inside and outside Italy have lowered expectations for the economy, predicting not merely a savage recession, but at best a fragile recovery in 2010. The European Commission and the International Monetary Fund both now estimate that in 2009 Italy's GDP will shrink by 4.4%. The Bank of Italy and the employers' association, Confindustria, have plumped for 4.9%. And in the most recent gloomy analysis, the OECD on June 24th put the likely shrinkage of the economy this year at 5.5%. True, three other G8 countries are doing worse still (see chart). But the notion that Italy, which has a 20-year history of underperformance, will miss the full impact of the recession is fanciful.

The OECD survey, in particular, clearly embarrassed Mr Berlusconi. He responded this week angrily that it was time to "shut the mouths" of those who spoke of "crisis here and crisis there". He also suggested that companies should withdraw advertising from newspapers that spread gloom (even though his own finance ministry had in May quietly altered its own estimate of the fall in GDP to 4.2%).



In Italy appearance and reality seldom coincide. Many economists and businesspeople assume that, as so often, Mr Berlusconi's provocative rhetoric masks a subtler purpose. "I think that [Berlusconi and his finance minister, Giulio Tremonti] are most afraid of a drop in internal consumption and are trying to drive it up," says Michele Tronconi, president of the fashion industry's trade body, Sistema Moda Italia. Mr Berlusconi has all but admitted as much. "We need to try to revive consumption. People should go back to their previous lifestyles," he declared recently.

Yet if the plan is indeed to compensate for the loss of exports by hoodwinking the Italian consumer into spending more, it is a risky one, for both Italy's government and for the country. Mr Berlusconi already has a credibility problem at home over his private life, having refused to make good his pledge to explain to parliament his relationship with an 18-year-old aspiring model. He is now having to put up with a raft of stories about call-girls being entertained at his home in Rome. He can ill afford to have his claims about the health of the economy contradicted by the evidence of voters' own eyes and ears.

Mr Tronconi, who backs the government's optimism offensive, acknowledges that "my experience is of a crisis that is biting very hard". He heads a small, family-owned textile finishing company and output in his sector was down "nearly 30%" compared with 12 months ago.

Fabio Pammolli of CERM, an economics think-tank, notes that "being a country with a very fragmented economy, made up of small businesses, the moment at which the recession becomes visible is delayed. The collapse of thousands of micro-enterprises does not make the front pages in the same way as the bankruptcy of a Chrysler or General Motors." But it does show up in the figures. Istat, the government statistical office, says that 204,000 jobs were lost in the first quarter of 2009. In April industrial production was down by 22% and orders by 32% on a year earlier.

By insisting that nothing is amiss, Mr Berlusconi and Mr Tremonti are also passing up an opportunity to embark on reforms that would not only speed the economy's recovery but actually improve Italy's productivity and public finances. Confindustria is pressing the government for more reform of the unsustainable pension system (Italy spends 13% of GDP on the elderly, almost four percentage points more than the average for the EU 15 richer economies). And it wants a programme of liberalisation and privatisation to promote competition, increase productivity and cut consumer-price inflation. A recent Bank of Italy study concluded that in three years such a programme could boost Italy's GDP by as much as 5%.

Since it returned to office last year, however, the Berlusconi government has become wary of free-market ideas. Guided by Mr Tremonti, author of a book foreshadowing the credit crunch, the government has embraced Sarkozyite ambiguity. It has no programme for deregulation or asset sales. It is not prepared even to raise the retirement age for women. Ministers have hinted that they fear courting unpopularity at an already delicate juncture.

It might be possible to steer through pension reforms and take on the vested interests opposed to liberalisation and privatisation if it were done in the name of national belt-tightening. Italians responded heroically in the mid-1990s when the then prime minister, Romano Prodi, called for sacrifices to clean up the national accounts to prepare for euro membership.

Yet although Mr Berlusconi may survive the scandals that have engulfed him, he can scarcely appeal to voters for blood, sweat and tears so long as he insists that Italy has emerged almost unscathed from the world's economic meltdown—rather as the barracks in which the G8 summit is being held weathered the earthquake.

Hip-hop in France

A hip-hop happening they had of it

Jul 2nd 2009 | PARIS
From The Economist print edition

A new festival marks the maturing of a gritty musical form

MarOne



Enengy from the banlieues

SUMMER is the season of arts festivals in France: opera in Aix-en-Provence, theatre in Avignon, jazz in Vienne. But one festival will have the purists frowning into their opera glasses: the Paris Hip-Hop Fortnight, which runs until July 5th. The French are better known for high culture, but the American-inspired street arts of rap, hip-hop and graffiti have become so vibrant in France that even officialdom has taken note.

The Paris Hip-Hop Fortnight is sponsored by the town hall and by the national government. More than 300 artists, from breakdancers to rappers, are taking part, at 18 venues. Highlights have included a concert by IAM, a hip-hop band from Marseilles, and an appearance by Grandmaster Flash, a pioneer of American rap. Even as French hip-hop flourished, official policy treated it as "a fashion, a sport, or an adolescent activity", as a 2005 report put it. "Now we're finally getting official recognition," says Bruno Laforestrie, who runs a hip-hop radio station and is director of the festival.

Many consider France to be the most happening hip-hop scene after America. In 2008 France won the world DJ-ing championship, a discipline that involves scratching and mixing tracks on two turntables, beating America into second place. French breakdancers have won three of the past ten world championships. Over the past 25 years, French rappers have drawn on their *banlieue* culture to devise their own form of rap. Many have been snapped up by big record labels. French rap varies from the crude, misogynist lyrics of NTM to socially engaged rappers such as MC Solaar or Diam's, a female artist of Cypriot origin who raps about pride in the *banlieues* as well as violence against women.

What explains the vibrancy of French hip-hop? One reason is the multiethnic, semi-ghetto culture of the *banlieues*, where themes of exclusion, drugs and violence that inspired American rap find an echo. Another could be official quotas for French-language music on radio. Some suggest that rap's urban poetry builds on France's lyrical singing tradition, from Edith Piaf to Françoise Hardy.

Traditionalists are dismayed by rap's linguistic contortions. The culture ministry did not sponsor the Paris event. The government has condemned a rapper for lyrics that it claimed incited violence against women. NTM was fined for abusive language and Joey Starr, one of its singers, was jailed for violence. But officialdom is beginning to give hip-hop its blessing, recognising it as an energising force in run-down neighbourhoods. Even the staid Grand Palais has opened its doors to two hip-hop events. And, though it is surely coincidence, one of President Nicolas Sarkozy's sons happens to be a hip-hop producer.

Ukraine, Russia and gas

Energetic blackmail

Jul 2nd 2009 | BRUSSELS
From The Economist print edition

Efforts to extort money to avoid another gas cut-off come to nothing

IN BLACKMAIL timing can be everything. The governments of Russia and Ukraine have cause to ponder this after failing to extract billions of euros from the European Union in the name of keeping Russian gas flowing to Europe next winter.

Thanks to recession and competition from cheaper suppliers, European demand for Russian gas has fallen. It is also summer. So right now governments and gas companies are unusually brave over threats to cut off the gas. They have resisted pressure to give Ukraine a huge loan that both the Russians and Ukraine's squabbling leaders say is needed to avoid another dispute like the one that blocked Russian gas in January, affecting 18 of the 27 EU countries. Whether Europe's nerve will hold as winter approaches remains to be seen. Russia supplies 42% of all EU gas imports, and its share is rising.

In May Russia's prime minister, Vladimir Putin, told the EU that Ukraine must have help paying for gas to fill the Soviet-era storage tanks it uses to meet its domestic needs each winter. If Europe wanted to avoid cut-offs, an emergency loan of some $4.2 billion would be needed, he said. Russian officials and gas bosses added ominously that Ukraine was so cash-strapped it might miss a July 7th deadline for paying its June gas bill.

Ukraine's prime minister, Yulia Tymoshenko, also told EU officials that $5 billion was needed to avert a fresh gas crisis. Yet the price had fallen sharply when the Ukrainians attended a meeting in Brussels on June 29th with officials from the EU, the IMF and other institutions to discuss upgrading the country's creaking gas infrastructure. Sources say that the Ukrainian envoys now wanted only $2.1 billion to ward off trouble next winter.

The Czech Republic, which has held the rotating EU presidency in the first half of 2009, recently sent round a "non-paper" (jargon for an internal discussion document) that set out the case for ignoring all demands for money. The paper's argument was that European gas companies have contracts with Gazprom, the Russian state-owned gas giant, to buy gas at delivery points on the EU border. The cost of transit through Ukraine is already included in the price. So it is for Gazprom to fulfil the contracts it has signed; neither European companies nor governments should be expected to pay twice. Sweden, which took over the EU presidency on July 1st, is said to take a similarly robust view.

Amid the murk of contrary claims, some clear points stand out. First, Ukraine's gas stores matter, because when it draws on them to meet domestic demand (as it did in January) it disrupts flows in the pipes used to ship gas from Russia to Europe. Second, a lucky few make vast sums from Russia's trade in gas with Ukraine, much of which flows through unmetered pipes in quantities and at prices that are secret. Third, even a loan to Ukraine to buy winter gas might not avert a crunch. Ukraine has used less Russian gas this year than it promised to buy. Under "take or pay" terms common in the industry, Russia may bill Ukraine for the unused gas. By October, that bill could reach $3 billion, which Ukraine may say it cannot pay. (The Ukrainians already struggle to afford the cost of domestic gas subsidies; the political cost of putting up prices would be high.)

In short, a new gas crisis is still quite possible, and once again Europe will have no way of knowing what lies behind it. If Russia and Ukraine had wanted to find a way to encourage the EU to diversify away from Russian gas, they could hardly have come up with a better one.

Reforms in Turkey

Marching along

Jul 2nd 2009 | ANKARA
From The Economist print edition

Tension between the army and the government may promote reforms

AP

COULD it be Turkish democracy's great leap forward? On June 26th Turkey's parliament, dominated by the Justice and Development (AK) Party, passed a groundbreaking law allowing civilian courts to prosecute army officials. Four days later a civilian prosecutor charged and briefly arrested a serving colonel for his alleged involvement in a plan to overthrow AK.

Colonel Dogan Cicek is at the centre of an alleged conspiracy that has rocked the political establishment since it was exposed by a Turkish newspaper last month. The army has ordered an investigation. But it has just as promptly declared the colonel to be innocent and the document, entitled "The Plan to Combat Islamic Fundamentalism", a fake. In the old days, the army's growls would have cowed the civilians into silence. But contrary to speculation that he would retreat, Recep Tayyip Erdogan, the prime minister, appears this time to be holding his ground.

So is General Ilker Basbug, the chief of the general staff. He is said to be pressing the government to reconsider the bill that will allow coup plotters to be tried in civilian courts. He made his views known during a day-long meeting of the National Security Council on June 30th. The main opposition Republican People's Party (CHP) also wants the constitutional court to strike the law down, saying it violates other provisions of the constitution. Never mind that CHP deputies voted in favour of it: they claim they were "tricked" into doing so by AK. All eyes will now turn to Abdullah Gul, Turkey's president, who could send the constitutional amendment back to parliament on the grounds cited by the CHP. "If he does so, his credibility will suffer an enormous blow," argues Taha Ozhan, who runs SETA, a liberal think-tank in Ankara. "This [bill] constitutes the biggest challenge of this [two-year-old] presidency," he adds.

It is also the biggest challenge to the army's immunity. Ever since catapulting into government seven years ago, AK has been chipping away at the generals' power. The National Security Council, through which the generals often dictated foreign and domestic policy, has been downgraded to an advisory role. A string of abortive coup plans leaked to the media and crude attempts to block Mr Gul's elevation to the presidency have dented the army's image and bolstered that of AK.

The latest coup talk may have galvanised Mr Erdogan into a fresh burst of reformist zeal. The government is talking of reopening a Greek Orthodox seminary on the island of Halki off Istanbul, a long-running demand of the European Union. Mr Erdogan also says that talks with the IMF for a new standby deal will resume soon. This helped the Istanbul stockmarket to recover this week, despite the news that gdp had shrunk by a whopping 13.8% in the year to the first quarter of 2009.

Turkey's secular elite, which has often seen the army as the sole guarantee of a freewheeling lifestyle inspired by Ataturk, is understandably nervous. Many fear that AK's real mission is not to democratise Turkey but to convert it to Islamic rule. They might take heart from a parade in Istanbul's main square on June 28th to mark international gay pride day. Girls in tightly wound Islamic headscarves took turns to be photographed with scantily clad transvestites. "We have nothing against them, Allah created us all equal," opined a bystander who identified himself as a pious Muslim. "This is the kind of freedom we long for in Iran," sighed Ali Akbar, an Australian tourist of Iranian descent.

The deeper worry among Turkey's secular elite is not about creeping Islam but over a loss of power to an encroaching class of pious bureaucrats and entrepreneurs that has become increasingly visible since Turgut Ozal, a modernising former prime minister, liberalised the economy after the generals' third and most recent direct coup in 1980. And are the days of coups over? That the question can still be posed

suggests that a risk remains of further military intervention, however small. “The generals feel cornered, and that makes them dangerous,” says a veteran military observer. That may explain why some in the government would be relieved if the constitutional court did indeed strike down their new law.

Albania's tight election

Close but no government

Jul 2nd 2009 | TIRANA
From The Economist print edition

A draw in Albania means horse-trading and perhaps a new election



FOR months the opinion polls suggested that Albania's election would be close. Most pundits said they were wrong, because respondents were giving unreliable answers. Now Albanian opinion polling has come of age. So close was the June 28th election that, four days later, the result was still unclear. Albania faces weeks of election challenges and political horse-trading—and perhaps even a fresh election in the autumn.

The poll pitted the prime minister, Sali Berisha, who has dominated Albanian politics ever since 1990, against the mayor of Tirana, Edi Rama. Both Mr Berisha's centre-right Democratic Party and Mr Rama's Socialists have alliances with smaller parties. With almost all votes counted, Mr Berisha was claiming 71 seats in the 140-seat parliament, but Mr Rama's party hotly disputed this.

Mr Berisha campaigned on his government's achievements since 2005. The economy has done well. Last year GDP growth was 6.5%, and even in this year of world recession it is expected to be positive. In April Albania joined NATO and formally applied to join the European Union. New roads have been built, including a major highway to Kosovo.



Mr Rama has achievements of his own in Tirana, which is much improved from the chaotic place it once was. He has painted Mr Berisha as a demagogue in charge of a deeply corrupt government, arguing that it is time for a change. Yet Mr Berisha also talked of change. In fact, both men were coy about specific policies. They agree on the main issues facing the country: job creation, visa-free travel for their citizens and faster European integration. The issue for voters was whom they trusted most.

Given the drama and violence of Albania's political life since the collapse of communism, and the corruption of some politicians, this election was the first that could be considered normal, says Remzi Lani, a political analyst. It was Albania's first "vote of choice not of protest". But the prospect of an equal balance in parliament makes it hard to see a stable government being formed, says Erion Veliaj, leader of the small G99 party. Albania might have to have a new election in a few months' time.

This is not what the country and the wider Balkans need. This week Croatia's prime minister, Ivo Sanader, unexpectedly stood down, raising new questions over how soon Croatia might actually get into the EU. Most other western Balkan countries have much further to go. Albania is the poorest of the lot. The IMF has given warning that Mr Berisha, in a bid to secure votes, has rushed to finish big projects such as the road to Kosovo, running up a dangerous budget deficit. Remittances from the quarter to a third of Albanians who live abroad have dropped sharply. A construction boom has turned to bust. Thousands of new flats are empty and brand new blocks of unsold ones line roads out of Tirana, Durres, Vlora and other towns.

Zef Preci, an economist and former minister, cautions that although Albania is not in recession, it may be soon. "The real challenge is not the decrease of remittances," he says. "It is the return of emigrants which has not started." He also notes that the 1930s Depression hit Albania several years later than other countries. Whoever runs the next government will find the job a tough one.

Kosovo and media freedom

No criticism, please

Jul 2nd 2009 | PRISTINA
From The Economist print edition

Political bigwigs in Kosovo harass its brave free media

EXACTLY 20 years ago Slobodan Milosevic, Serbia's leader, spoke to Serbs at Gazimestan, the site of the Battle of Kosovo on June 28th 1389. The speech came to be seen as a significant step on the path to war in the former Yugoslavia. This year thousands of Serbs turned up for the battle's commemoration, including several Serbian ministers. They were escorted by police from Kosovo, which declared independence from Serbia in February last year.

The escort and the arrival of so many Serbs are signs of the times. Serbia continues to reject Kosovo's independence. The Serb-dominated north of the country is under de facto Serbian control. And yet tensions between Serbs and Kosovo's ethnic Albanian majority are low. This week most of Kosovo's Serb policemen, who were pressed by Serbia to resign on independence, returned to work.

Kosovars no longer fear that their independence will be reversed. On June 29th Kosovo joined the IMF and the World Bank. Some 60 countries now recognise the country. One result of this new confidence is that Kosovo's journalists are now complaining about a lack of freedom, rather than keeping quiet for patriotic reasons.

This blew into the open a month ago when a newspaper close to Hashim Thaci, the prime minister, began a campaign against Jeta Xharra, a television journalist whose shows have covered such controversial topics as alleged war crimes committed by Kosovar guerrillas in the 1990s. When Ms Xharra clashed with a mayor from Mr Thaci's party, in jail for four months of his term for threatening a judge, the mayor used the same newspaper to call her a Serbian agent. Another article said she had "brought it upon herself to have a short life."

Mr Thaci appeared shocked when diplomats demanded a condemnation of such behaviour. His government responded by coming up with a general one, but it did not mention the Xharra case. Hajredin Kuci, the deputy prime minister, rejects the notion that the Xharra affair is symptomatic of a wider problem. He points out that she is still on the airwaves of RTK, the public broadcaster. But Vjosa Dobruna, chairman of the board of directors of RTK, says that "the government is blackmailing us. They are pressuring us to keep in line." She says they do this by keeping RTK in suspense over its financing.

Migjen Kelmendi, head of Rrokum, a cable television channel, says that robust criticism of Mr Thaci led to the axing of the channel in April by Kosovo's main (pro-government) cable provider. Agron Bajrami, editor of *Koha Ditore*, Kosovo's bestselling daily, says that he and his journalists have often been threatened or harassed by government bodies and public companies. A judge under investigation threatened to kill one of his journalists who rang to ask why. Critical and investigative stories lead to a loss of crucial advertising, says Mr Bajrami. For now, he says, "We can take the losses, but others cannot and they have to make compromises."

Charlemagne

Those exceptional Swedes

Jul 2nd 2009
From The Economist print edition

Why Sweden usually makes a good president of the European Union

Illustration by Peter Schrank



HERE are three Europeans, talking about the best way to help car workers in the recession. For the first, the state must use "all means necessary" to preserve key industries: ie, give carmakers billions of euros. In return, it is "quite normal" to ask them to halt lay-offs, to keep existing factories open and if possible to "bring production home" from lower-cost countries.

A second European says that governments should focus on ensuring individual workers are employable, not propping up uncompetitive firms. For him, the problem with the car industry lies in "the overproduction of cars that nobody wants to buy." That leads him to a blunt conclusion: save the workers, not the factories that turn out such clunkers. In his words, "when a ship is sinking my main aim is to save the sailors, not the ship."

That robust second view is echoed by our third European. It is natural for labour-intensive jobs to go to low-cost countries, he says. Higher-cost countries can make things only if they innovate, focus on high-end products and ensure they are the "best in class" worldwide. But if firms are not competitive they should not survive. "Nobody is helped by having people employed in companies that aren't viable."

The first European is Nicolas Sarkozy, the French president. The second is Sweden's centre-right prime minister, Fredrik Reinfeldt, who recently refused to rescue a loss-making carmaker, Saab (though when a Swedish-led consortium agreed to buy Saab from General Motors, his government was ready to offer loan guarantees). And the third is Aleksandar Zuza of a Swedish trade union, IF Metall, which represents production workers at Saab. Speaking for his centre-left trade union, Mr Zuza grumbles that Mr Reinfeldt is too negative about Saab. GM starved the brand of investment, he adds, and Saab should be given a fighting chance under new owners. But if Saab is not competitive in a couple of years, he adds, "that will be that". In other words, the Swedish left and right basically agree: and both are a lot more liberal than the (nominally centre-right) president of France.

Sweden, in short, is an exceptional place. On July 1st the Swedes took over the rotating presidency of the European Union for six months. They will oversee the writing of new EU rules on financial supervision and regulation. They must craft a common EU position to take to the Copenhagen climate-change conference in December. And their presidency will be filled with institutional chores. The coming months will see the appointment of a new European Commission, and—if Irish voters say yes to the Lisbon treaty in a

referendum in October—two new jobs will need filling: a foreign-policy chief and a full-time president of the European Council, representing the 27 national governments. Swedish exceptionalism will shape all of these dossiers.

For years Sweden has made lefties swoon. When Mr Reinfeldt came to power in 2006, the Social Democrats had run the country for 65 of the 74 previous years. Sweden has a huge public sector (in 2007 taxes and social-security contributions swallowed more than 48% of GDP), yet even the flintiest liberal has to admit that it is an exceedingly well-run, handsome place. Its fearsome levels of organisation and conformity are offset by a relaxed, outdoorsy culture, and the openness that goes with being a small, maritime country. If Zurich were crossed with Sydney, the result might be something like Stockholm.

Others say political labels are misleading. Sweden's big state works because it is Swedish, not because it is big, says Johan Norberg, a liberal economist. The country has had an efficient bureaucracy for 200 years. The public sector expanded only in the 1950s, after a century of astonishing economic growth driven by free trade and free markets (from 1850 to 1950, average incomes multiplied eightfold, as a poor peasant society was transformed into one of the world's richest countries).

The Stockholm consensus

Their own banking crisis of the 1990s combines with today's credit crunch to persuade Swedes of the need for tougher cross-border financial regulation. But they do not want to see it imposed from on high. In the 1720s, when the Swedish king was abroad "making wars", the government shored up national unity by taking big decisions by consensus, says Mats Odell, the financial-markets minister. EU decisions on financial regulation can, in theory, be taken by majority vote. And some countries would be happy to outvote Britain and impose rules that would rein in the City of London. But that is not Sweden's plan, says Mr Odell: Swedes believe that consensus is the best way to take long-term decisions that all can live with.

Swedes often draw lessons from past success (this can make them sound smug). In climate-change talks, it will make them rather tough. Sweden has cut carbon emissions by a tenth since 1990, even as its economy grew by 50%, Mr Reinfeldt said this week. He calls his country "an interesting example" for others. When it comes to the Lisbon treaty, Swedes are wary of anything that smacks of EU bossiness, or a power-grab by big countries (though Mr Reinfeldt has also called Sweden the world's smallest superpower). Swedish ministers are dubious about the new job of president of the European Council, preferring the idea of an "elected chairman" who can organise meetings of the 27 leaders.

Sweden is different in other ways, too. Its voters are more favourable to EU enlargement than almost all others. That is matched at government level: Sweden's foreign minister, Carl Bildt, strongly backs EU membership for Turkey (he is also robust over Russia). A giant in a Europe of diplomatic pygmies, Mr Bildt would make a fine EU foreign-policy chief. Alas, his brilliance is matched by a reputation for arrogance (ie, he is Swedish), so some countries may block him. A pity.

Economist.com/blogs/charlemagne

Correction: Jan Fischer and Opel

Jul 2nd 2009
From The Economist print edition

Because of an editing error, Charlemagne on June 27th referred to the Czech prime minister as Ivan not Jan Fischer; and on June 20th described a bidder for the carmaker Opel as an Austro-Russian not a Canadian-Austrian-Russian consortium. Sorry. These mistakes have been corrected online.



Gordon Brown's latest relaunch

The election starts here

Jul 2nd 2009
From The Economist print edition

The policies that will pave the way for next spring's contest

Getty Images



THERE are few trustier gambits in the Brownite playbook than the set-piece parliamentary announcement. As chancellor of the exchequer Gordon Brown supplemented the annual budget with a pre-budget report and a biennial spending review. These opportunities to set the terms of debate, and to stage carefully prepared appearances rather than have to think and communicate on his feet, continue to enthuse him as prime minister.

The latest example, a preview of the government's legislative agenda on June 29th, doubled up as the unofficial start of the general-election campaign. Mr Brown's bills will be fully itemised later this year in the Queen's Speech, another government-managed exhibition in Parliament. But most of the policies he plans to pursue before going to the polls, most likely next spring, are now apparent.

As part of a constitutional tidying-up exercise, the House of Lords will see its remaining hereditary members removed, as well as new rules allowing the dismissal of peers guilty of misconduct. The Commons, recently disgraced by an expenses scandal, will also face tougher rules. Housing is another priority, with £1.5 billion ($2.5 billion) spent over two years to build new homes. Controversially, local authorities will be allowed to favour local people over recent immigrants in allocating social housing. And, lest voters sense a complacent assumption among ministers that the economy is fading as a concern, there will be new sticks and carrots to get unemployed young people back to work.

Public services, though, are the focus of Mr Brown's latest attempt to relaunch his premiership. The conflict between Tony Blair's zeal for market-based reforms and his successor's preference for central standards backed by big spending splintered Labour for years. But now something of a synthesis (the Conservatives say a fudge) seems to be emerging. In health and education certain entitlements to service are to be guaranteed by the government. But the means of ensuring that they are met will be thrown open: private hospitals will treat patients who have been waiting too long for treatment, and tutors will give remedial classes to failing schoolchildren. The idea of minimum entitlements is not new, however, and many wonder whether, without statutory backing, they count as the "enforceable rights" they are sold as.

“Building Britain’s Future”, the grandiloquent title Mr Brown gave his plans, is hardly the bold vision he has been promising to expound since becoming prime minister two years ago. The thinness of last year’s Queen’s Speech was understandable: recessions have a way of shunting most other policy issues to the margins. But it also damaged Mr Brown, as the lack of a strong domestic narrative allowed his government to be buffeted around by events as frivolous as a botched YouTube appearance in April. It is not obvious that his latest batch of ideas will prove a stronger umbrella against the political weather.

In any case, more eyes and ears are trained on the parallel debate about public spending. Mr Brown, as he did successfully at the two previous general elections, portrays the Conservatives as eager to cut public spending. In turn David Cameron, the Tory leader, points to the government’s own scheduled cuts. He implores the prime minister to ditch this artificial dividing line and be candid with voters about the need for fiscal retrenchment whoever forms the next administration.

Mr Brown seems to be fighting the last war: fear-mongering claims about spending cuts which worked in 2001 and 2005, when money was cascading into the Treasury and voters viewed the Tories as malign, are less persuasive at a time of record borrowing and sunnily rebranded opponents. Unhelpfully for Mr Brown, Alistair Darling, his independent-minded chancellor, stresses the urgency of chipping away at public debt. Other ministers are struggling to repeat Mr Brown’s electioneering mantra of “investment versus cuts” with conviction. And the spending review that should have been due this year seems to have been postponed—to save the government the ignominy of elucidating its own planned cuts, says Mr Cameron.

Yet Mr Brown’s substantive position on spending does not have to be right, or even internally consistent, for his determination to fight on this turf to be clever politics. As long as the issue of the day is spending on schools, hospitals and the like, rather than Mr Brown’s personality or his record of economic management, it may be that Labour still has a chance to prosper. Elections, to summarise this calculation, are fought not between competing answers to the same question but rather between competing questions.

If this is to be Mr Brown’s last year in office, say many on the left, he should spend it pleasing Labour’s grassroots. There are reasons other than his rhetorical commitment to investment to think he might. Millions of public-sector workers, even if they know cuts are coming, may trust Labour to lower the axe more gently than the Tories. On June 30th Alan Johnson, the home secretary, announced that identity cards, particularly unpopular among left-wingers, would never become compulsory for British citizens. The day after that, Lord Mandelson, the business secretary, said there was “no prospect” of his proposed part-privatisation of Royal Mail going ahead in current economic conditions. Hours earlier the government declared that it would take a railway line run by National Express, a train franchise, into state ownership.

This may all be coincidence. But taken together with parts of the legislative agenda, something approaching a core-vote strategy could be in the works. Mr Brown has never done anything like this before: he urged Labour to contest the centre ground as a young moderniser, and helped inspire the party’s centrist election campaigns in 1997, 2001 and 2005. But it may be the only way to spare his party an electoral rout. However deep the irony of Mr Brown repudiating the habits of a political lifetime, the logic may prove irresistible.

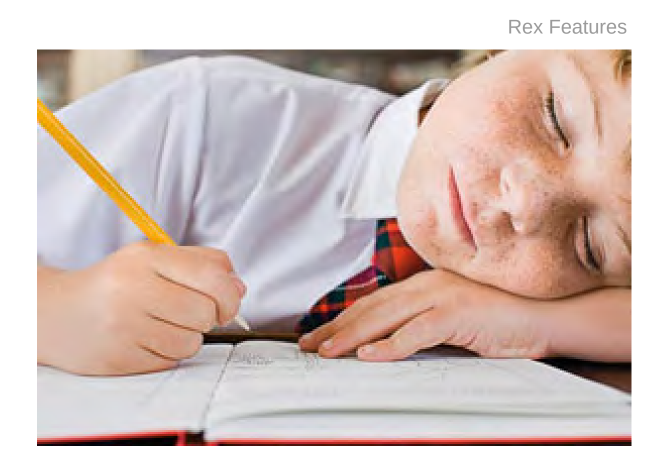
New plans for schools

Never-ending story

Jul 2nd 2009
From The Economist print edition

The next instalment in an epic adventure in education

Rex Features



TO HEAR Ed Balls, the schools secretary, tell it, the saga of British education since the Labour Party came to power in 1997 is a rousing one of derring-do. The government set targets for literacy and numeracy—and lo, literacy and numeracy rocketed. It prescribed teaching methods in these basics (and much else)—and teaching standards soared too.

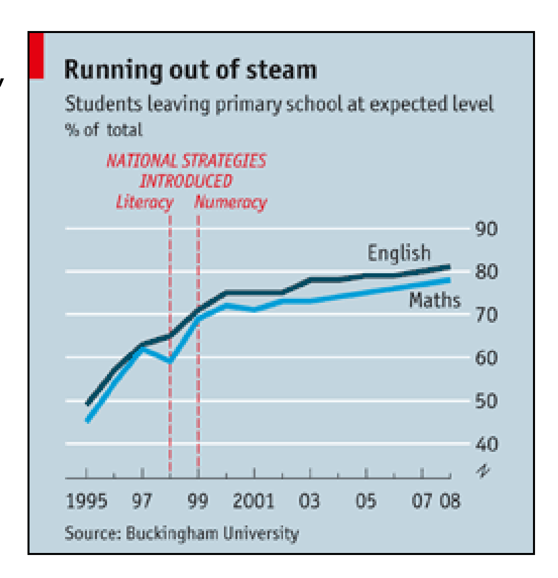
The next chapter in this absorbing drama was foretold on June 30th, in the latest education white paper. Parents will be able to demand catch-up tuition for their darling dullards, or challenging lessons for their gifted lads and lasses. They will be enlightened by new school "report cards" that set out matters academic (exam and inspection results), social (sport and healthy eating) and sundry ("partnership working" with other schools), both separately and in an overall grade. Naughty children will finally be tamed by forcing parents to sign agreements to make them behave. Teaching will be transformed (again) by re-licensing teachers every five years.

"Efficiency savings" and pots of unneeded contingency money will cover it all, claimed Mr Balls—a tall order, if the fifth of children leaving primary school below par in literacy or numeracy are to get real help. Report cards could be useful—though only if nonsense like partnership working counts little towards the grade. Not so teacher licensing. Unlike lawyers and doctors, teachers need not keep up with fast-paced changes in their profession; they would do better to resist pedagogical fads. And the way to raise the status of teaching, another alleged benefit of licensing, is to attract go-getters into it. More box-ticking and hoop-jumping will only make that harder.

There was one truly promising measure: the government is to end the £100m ($165m) a year contract with Capita, an educational-consulting firm, to run its "national strategies" for primary schools. These detailed prescriptions for teaching a range of subjects evolved from the literacy and numeracy strategies, launched in 1998 and 1999 respectively. Mr Balls thinks that, together with the targets set for children's achievements in national tests, they have driven up standards, but reckons schools are now capable of running the strategies themselves.

Another version is that the government has blown £2 billion on micro-managing teachers, and to little effect. Standards rose quickly after the previous (Tory) government introduced national tests, but in maths, especially, improvement has slowed since Labour introduced its strategies (see chart). "It would have been better to hone the blueprint they inherited: a national curriculum,

external tests and rigorous school inspections," says Alan Smithers, an education expert at Buckingham University. But that, presumably, did not seem sufficiently action-packed.



Economic prospects

After the fall

Jul 2nd 2009
From The Economist print edition

Any revival will be from a terrible starting point, and may prove anaemic



FEW politicians have more acute antennae than Peter Mandelson, now in effect the deputy to Gordon Brown. In January the business secretary slapped down a junior minister when she spotted some premature green shoots of economic recovery. But this week Lord Mandelson felt confident enough to say that the worst of the recession was over, and that the economy was on course to return to growth later this year.

That is certainly the story being told by business surveys that measure the pulse of activity. After detecting a nascent recovery in private services in May, purchasing managers sensed a further improvement in manufacturing in June. They reported on July 1st the first increase in output in this hard-hit sector since March 2008.

Like manufacturing, construction has been clobbered during the downturn. But the worst may be over for residential builders as the housing market stabilises. Earlier this year house prices had fallen by 20% since their peak in October 2007, but more recently they have been steadier, rising by 0.9% in June according to Nationwide Building Society. The Home Builders Federation also reported the biggest annual rise in net reservations to buy new homes in May for three years.

But if signs of revival are emerging, they are following a downturn that was even worse than previously thought, according to revised national accounts published on June 30th. Such revisions are usually of interest only to nerdy data-spotters but these broke records. They showed that GDP dropped by 2.4% (rather than the earlier estimate of 1.9%) between the last three months of 2008 and the first quarter of 2009. The recession, now reckoned to have started in the second rather than the third quarter of last year, is already the worst in post-war history, with output down by 4.9% (rather than 4.1%) since the start of 2008, another dismal record.

Amid the gloom engendered by this rewrite of recent economic history there is one ray of light. One reason the downturn has been so severe is that firms have trimmed inventories savagely. Sooner or later they must satisfy demand from new production, and this will boost the economy. A case in point is Honda, a Japanese car company, which closed its assembly lines in Swindon from February to May but reopened them in June.

Another reason to expect an upturn is that monetary and fiscal policy are working flat out to revive the economy. The Bank of England is keeping the base rate at a record low of 0.5% and creating money by buying £125 billion ($206 billion, equal to 9% of GDP) of securities, mainly gilt-edged government bonds. Figures out this week show that the quantitative easing has had little effect so far on the broad-money supply held by non-financial firms and households, not least since many of the purchases have been from foreign holders of gilts. But it may have helped to stifle expectations of deflation, the last thing an over-indebted economy needs.

Fiscal policy is also extraordinarily loose, as the deterioration in the public finances testifies. That is causing alarm because the government has not spelt out a credible plan for fixing the structural budget deficit. In a survey of the British economy published on June 29th, the OECD, a rich-country think-tank, called for faster retrenchment once a recovery is under way. But while the economy remains so weak, it requires fiscal and monetary support.

These counterforces to the downturn look strong enough to end the recession before too long. The real worry is whether that recovery will be sustained; and, if it is, whether it will be weak rather than strong.

Any bounce in activity from a turnaround in the stock cycle will be short-lived if underlying demand fails to revive. Since personal debt is still high, people will want to save more, which will keep spending in check. With business investment also likely to be weak as firms curtail their borrowing, recovery will hinge on trade. The big fall in sterling will help exporters but what is really needed is a quick, strong upturn in Britain's main foreign market, the euro area, which does not seem likely.

Even if a sustained recovery does get under way, it will be tempered for several years by fiscal retrenchment and the reversion to more normal monetary settings. The OECD also said in its report that past growth in Britain had been unsustainable and driven by a credit boom. Any recovery would be sluggish, with growth "expected to remain well below trend as households and firms rebuild their balance sheets". That gloomy forecast seems all too realistic following so grave a financial crisis.

ID cards for farm animals

Shepherd's warning

Jul 2nd 2009 | EDINBURGH
From The Economist print edition

Britain digs in its hooves over EU rules on electronic tagging

Illustration by David Simonds



MODERN food-production methods move animals about a lot before they wind up on dinner tables. So, as the British government found out in the 2001 outbreak of foot and mouth disease (FMD) among cattle, tracing the origins of an epidemic can be tough. To make disease control easier, the European Union decided that all sheep, which also get FMD, should have identity cards in the form of electronic ear tags. That way they can be monitored, just as supermarkets use radio-frequency identification microchips in packaging to track their stock. Tracing infected animals back to their home farms is crucial for disease control.

It seems a good idea. It should also make controlling scrapie, a nasty sheep disease that can remain undetected for years before symptoms show, much easier. America started using the same technology in 2001 and stepped up an animal-testing programme to wipe out scrapie. The disease turned out to be more widespread than was first thought but, since 2005, the number of flocks testing positive has fallen by about 77%.

Yet British farmers, with 33m sheep or 24% of the EU's total flock, don't want to be herded down that route. Nigel Miller, a sheep farmer in the Scottish Borders, says that tags at up to £1.20 ($1.97) apiece, reading machines costing something between £400 and £2,500, and the time it takes to keep records will add about £3 to the cost of rearing a sheep. For blackface hill sheep fetching around £20 at market, that is quite a fleecing. Britain's big hill-sheep flocks are harder to round up, more prone to losing ear tags and more likely to stray than mainland Europe's pampered field-penned beasts, he says.

Such is the uproar that the EU's sheep-taggers have agreed to postpone making the scheme compulsory until the beginning of 2010. Meanwhile Britain's farming unions are trying to get the rules relaxed, for example by requiring that tags be read only when flocks get to market. Eurocrats, egged on by Spain and Italy, where farmers are a lot farther down the tagging track, seem to think that this is so much empty bleating. So British shepherds are venting their ire on Hilary Benn, the agriculture secretary.

Given how hard it is proving to mandate ID tags for sheep, it is perhaps unsurprising that the government is rethinking ID cards for people. On June 30th Alan Johnson, the home secretary, announced that Britons would not, after all, be required to have them.

PFI deals in recession

Singing the blues

Jul 2nd 2009
From The Economist print edition

Recession is heaping problems on a controversial form of public investment

Illustration by David Simonds



SQUINT a bit and it could be the early 1990s. The recession—and the government's subsequent Keynesian conversion—has shattered the cosy consensus that once existed on public spending. At a bad-tempered Prime Minister's Questions on July 1st, David Cameron, the Conservative leader, accused Gordon Brown, and not for the first time, of misleading the public over the scale of the spending cuts (or tax rises) needed to bring the national accounts back into balance. For his part, the prime minister is keen to raise before the public the old spectre of "Tory cuts".

Spending is shaping up to be the main battleground of the next election. That will refocus attention on the Private Finance Initiative (PFI), a public-spending approach under which private firms build and run bits of national infrastructure in return for decades of payments from the government, all enforced by contracts lasting for 20 or 30 years. First dreamed up under John Major, the last Conservative prime minister, the scheme has expanded hugely under Labour. From relatively simple projects to build roads and bridges and the like, large chunks of public spending have fallen within its ambit, including Labour's much-trumpeted new schools and hospitals as well as prisons (see article) and mid-air refuelling jets for the Royal Air Force. The PPP Forum, a trade association for firms taking part in PFI schemes, reckons that 630 of them have been put in place since 1992, covering investment of £63 billion. Unison, a trade union sceptical of PFI, says taxpayers will pay private firms £217 billion in "user charges" for these facilities between now and 2033.

But PFIs are suffering in the downturn. Most such deals include plenty of debt finance, and, with banks reluctant to lend, private companies are struggling to fulfil their contracts. In March, amid talk of protecting jobs and investment, the government rushed to rescue its PFIs, setting up a miniature infrastructure bank within the Treasury that is designed to provide up to £2 billion to PFI schemes frustrated by frozen credit markets.

The new bank has completed its first deal, paying £120m towards an energy-from-rubbish scheme in Manchester. But it has not gone down well: Vince Cable, the Treasury spokesman for the Liberal Democrats, dismissed the plans as a "ludicrous charade", and the Tories are no happier. Privately, even some of the consultants who advise on PFI deals admit that channelling public cash into "private" finance initiatives seems perverse. Many worry that the government will be tempted to fund projects because they are appealing for political reasons rather than because they are cost-effective. The Treasury insists that by the time its bank gets involved such decisions have already been made.

This ill-temperedness reflects the long controversy over the whole PFI approach. In theory PFIs should provide better value for money than conventional government procurement and transfer much of the risk in building infrastructure from the state to private firms. To its boosters, PFI represents an efficient way to fund investment while keeping operational spending safe from salami-slicing politicians of the future. Its detractors see it as expensive pork for the private sector, and an accounting wheeze preferred because it buffs the government's fiscal statistics.

The data to back up the value-for-money claim are sparse. A 2003 survey from the National Audit Office concluded that, broadly speaking, PFI contracts did offer good value for money. But there have been embarrassments. The cost merely of writing the £15.7 billion contracts to upgrade London's underground railway, for instance, was around £400m, and one of the deals has since collapsed. Jean Shaoul, of the

University of Manchester's business school, has studied the accounts of the first 12 hospital PFI projects and reckons that the companies concerned were earning an average return for shareholders of 58%. Because governments can usually borrow more cheaply than private firms, contractors must find big efficiency savings to offset that disadvantage—about 25% in the hospitals Ms Shaoul studied.

There is mixed evidence on risk transfer too. Several contractors have had to cover the costs of building works that have gone over budget. But it has not always worked that way. When Metronet, one of the firms contracted to upgrade the Tube, collapsed in 2007, it emerged that 95% of its bank loans had been underwritten by the government, which had to come up with £1.7 billion as a result. Margie Jaffe of Unison, which has been monitoring the PFI deals, argues that risk transfer is never absolute because the political consequences of letting most PFI projects go to the wall are usually too great.

Cynics suspect that the government remains keen on PFI not because of the efficiencies it allegedly offers but because it allows ministers to perform a useful accounting trick. "From the beginning PFI was an attempt to get spending off the balance sheet," says Tony Travers, a local-government expert at the London School of Economics. Until recently, long-term obligations to PFI contractors did not figure in the public accounts, which flattered the public finances. But now new international accounting rules require the government to disclose the liabilities. Bizarrely, departments have been instructed to produce two separate sets of accounts, one which includes their PFI liabilities and one which does not.

With a fiscal crunch looming, the political appeal of such financial alchemy can only grow. But keeping PFI spending off the books lends weight to charges of official dishonesty. Britain's fiscal outlook worries investors, as proved by the threat in May by Standard & Poor's, a rating agency, to downgrade Britain's credit rating. Mr Brown may be right that voters want spending to continue. He may even be right that PFI is the best way to deliver it. But the case would be more convincing without cooking the books.

Private prisons

Criminal enterprises

Jul 2nd 2009
From The Economist print edition

How PFIs have worked in the justice sector

"IT IS not appropriate for people to profit out of incarceration," said Jack Straw, then an opposition MP, in 1995. Mr Straw is now the justice secretary, and he has changed his mind. There are 11 privately run prisons in England and Wales, holding about a tenth of the total jail population, a bigger chunk than in America or anywhere in Europe. Mr Straw now wants to commission five more. Like most existing private jails, they are likely to be built and run through a Private Finance Initiative, or PFI.

Getting the private sector to build and run prisons has brought tangible benefits. One is speed: private jails are built in as little as two years, rather than the seven that they used to take when the government did the building. Running costs are lower too, mainly because staff are paid a quarter less than in the public sector (though senior managers are paid more) and get fewer benefits.

Generally, standards have not suffered. PFI prisons have frequently missed targets for the amount of "purposeful activity" that prisoners should do, but they still manage more than publicly run prisons. And they have injected a shot of customer-service culture into a charmless sector. Visiting hours are more flexible, thanks to shift patterns that public-sector unions resisted. At Altcourse prison, a tidy jail in Merseyside run by G4S, the biggest of Britain's contractors, wardens patrol without batons and address prisoners as Mr, a civility that is spreading to the public sector. Pay is lower than at the nearby (public) Liverpool prison, but guards get to interact with prisoners rather than just "patrolling a landing where everyone is locked up", according to one who has worked in both sectors.

The modern design of PFI prisons gives them this advantage over older, publicly run ones such as Liverpool. Prisoners can walk unescorted from cells to workshops, and staff are not deployed to supervise dark corners because there are none. The Prison Reform Trust, a sceptical lobby group, reckons that the private sector is cherry-picking bright modern prisons and leaving the grim Victorian ones to the public sector. Sure enough, when management of the unappealing Brixton jail (est. 1819) was put out to tender in 2000, no company made a bid. In January Anne Owers, the chief inspector of prisons, concluded in a report that the age of a prison helped to determine how well run it was, but its public or private status did not.

Many also fear that firms which make money from jails form a powerful pro-prison lobby. That is the last thing Britain, which already jails 50% more of its people per head than France, Germany or Italy, needs. Ministers may not be that easily swayed, but the revolving door between cabinet and private-sector jobs spins dizzyingly: in December John Reid landed a £45,000-a-year consulting role with G4S, whose services he had used as home secretary 19 months earlier.

Renationalising the railways

End of the line

Jul 2nd 2009
From The Economist print edition

Another retreat from the East Coast line shows confusion in railway policy

Alamy



And for our next act…

THE history of Britain's railways is a baroque and convoluted 150-year tale in which dozens of companies have merged, split, gone bankrupt, been nationalised, been reprivatised and so on. The latest twist came on July 1st, when the government announced that it was taking back the London-to-Edinburgh East Coast Main Line (ECML) because National Express, the transport conglomerate responsible for running trains on it, was no longer able to make its contracted payments. This comes just two years after the previous operator on the line, GNER, lost its contract.

The proximate cause is the recession. A smaller economy means fewer passengers. The drop in numbers was particularly sharp for profitable first-class travellers, as firms cut back on their travel budgets.

That short-term problem is interacting fatally with a longer-term determination on the part of the government to get the cost of the railways down. Subsidies were running at around £4.4 billion in 2007-08; ministers want to cut that by half over the next few years, with the railway's mostly well-off passengers picking up the tab in the form of higher fares. That enthusiasm for reducing the taxpayers' load has led train operators bidding for routes to promise huge efficiency savings that can then be funnelled back to the Treasury. National Express reckoned it could pay the government £1.4 billion a year by 2015, assuming that revenue grew by 10% a year until then. But in the first six months of this year revenues increased by only 1%. The company, which has debts of around £1.2 billion, forecast a first-half loss of over £20m.

In the past the state has often bailed out struggling franchise holders, allowing them to renegotiate terms midway through their contracts. Indeed Richard Bowker, the outgoing boss of National Express, used to run the Strategic Rail Authority, the body that agreed to such rescues. But officials have taken a harder line of late. In a radio interview, Lord Adonis, the rail minister, was unequivocal: "I'm simply not prepared to bail out companies that are unable to fulfil their commitments," he said, arguing that a rescue could encourage other operators to seek similar treatment.

Instead, a public company will take over the line until a new operator can be found. The route remains profitable, although a new owner will almost certainly promise less money to the taxpayer. That will matter to a Department for Transport desperate for funds to keep a clutch of badly needed projects—such as London's £16 billion Crossrail scheme and a £6 billion road-building programme—on course

But Lord Adonis went further, raising the possibility that the government might strip National Express of its other rail contracts, in East Anglia, east London and Essex, by way of punishment. That would prove to future bidders that the government was serious about transferring operating risk to the private sector, and would play well with a public that has never liked the idea of a profitmaking railway. But National Express points out that it does not run trains on the ECML itself. The job is contracted out to NXEC, a firm set up specifically for the purpose. National Express claims its financial obligations to NXEC run to only £72m. And it believes that, since NXEC and not the parent group would be in breach of its contract with the Department for Transport, the

government has no power to remove National Express's other franchises. An expensive and protracted legal punch-up looks likely.



Bagehot

The kindness of history

Jul 2nd 2009
From The Economist print edition

Gordon Brown may be thought of more charitably by posterity than by his contemporaries—if he goes honourably

Illustration by Steve O'Brien



ANTHONY EDEN equals the Suez crisis; Jim Callaghan connotes the "winter of discontent": such are the simplifications and cruelties of national memory. Most prime ministers, especially the short-lived kind, are remembered for a single achievement or, more often, for one defining failure. Few now recollect Eden's general-election win or Callaghan's proto-modernising; some leaders, such as Alec Douglas-Home, are barely remembered at all. Even those who bestride an epoch are eventually reduced to a couple of salient features. In the end "Tony Blair" will evoke Iraq, maybe with a footnote on his constitutional reforms.

Bagehot mentions this distillatory effect in order tentatively to advance an unfashionable view. It is that, odd as it now seems, history could one day come to regard Gordon Brown as a rather good prime minister, a much better one than he has been reckoned during his tragicomic premiership. At least, history might. Mr Brown may yet blow his chance of retrospective renown.

A favourable verdict on Mr Brown would not rest on the hotch-potch plan for Britain that he published this week (see article); the initiatives it touts are mostly either old and narrow or vague and remote. History may not be much interested in Mr Brown's timidity and confusion over many areas of policy: it will be indifferent to what he didn't do. It will, though, recall his bout of boldness last autumn, when the government bailed out the banks. The rescue plan may have been imperfect (the banks requiring further injections of capital); the credit for it might properly belong to others too; it was uncharacteristic in its decisiveness and sweep; Mr Brown may bear some responsibility for the regulatory regime that failed in the first place. But the bail-out was lauded and emulated around the world, and probably averted a catastrophic financial meltdown. If, in 20 years, Mr Brown is associated with just one initiative, this will be it.

There is at least a possibility—admittedly one that looked slighter amid the gloomy data released this week—that he will also be remembered for steering the British economy out of what had threatened to be a devastating recession, thus averting a fresh plague of long-term unemployment. Again, there are inevitable provisos, the most obvious of which is that the recovery hasn't happened yet. If it does, it may be more attributable to monetary policy and the slump in the pound than to government action, worthwhile though the stimulus package and loan-guarantee schemes may prove. But, at a distance, that complex and uncertain provenance may be a nicety.

The only other positive monumental legacies Mr Brown might leave behind are in foreign affairs (ironically, perhaps, given his general lack of interest in them). The G20 meeting he convened in April may not have been the pivotal, Bretton Woods-type summit that the prime minister hoped it would. But it could in time be seen as a gathering that recognised and institutionalised the dramatic shift in global power toward the emerging Asian economies. Meanwhile, Mr Brown's premiership may come to mark the moment at which British foreign policy abandoned its grandiose post-imperial delusions and settled into third-rank humility, giving up its ambition to sway wars and crises in faraway regions like the Middle East or the Caucasus.

As for much of the rest, all the galling shortcomings and shenanigans that pushed Mr Brown from authority to ridicule to pity and halfway back again: they will most likely fade and be forgotten. The YouTube fiasco and backfiring tax fiddles, the "bottled" general election and vicious spin doctors, the dictation of immigration policy by television actresses, even the regicidal plots and resigning ministers, will shrivel under the aspect of eternity. They have deformed Mr Brown's time in Number 10, but will in the long run seem the routine scars of political battle.

Two big political ruptures may, it is true, prove less perishable. One is the parliamentary-expenses scandal. History may fit Mr Brown up for that because it happened on his watch: to students in 2050, he may simply be the duck-island prime minister. On the other hand, the ruckus may turn out to be less transformative than it now feels. The other is the general-election humbling to which Mr Brown seems likely to lead his party. But history may be forgiving to him over that impending defeat—at least if Labour is not utterly annihilated—seeing it as the inevitable end of a superannuated government, of which he only latterly took charge.

This may seem partial, unfair, a distortion: history always is. But Mr Brown has at least a shot at reputational redemption.

Like the leaving of it

He will forfeit it, however, if he behaves disreputably in what seems almost certain to be his last 11 months in office. History may be forgiving to losers, but the manner of their exits can still undo them. How leaders comport themselves when their number is up (and afterwards: think of Edward Heath's sulk) can set the tone for their future memorialisation.

Few now remember the ministerial careers Eden and Callaghan enjoyed before they inherited the top jobs. Similarly, Mr Brown's cavalier management of the public finances as chancellor of the exchequer may stick instead to Mr Blair, whose name was above the main door for a decade. But Mr Brown will not escape opprobrium if as prime minister he presides over a debt problem that, through his refusal to face up to its dimensions and prescribe a credible remedy, sooner or later becomes a crisis. Then Mr Brown will be remembered for fantasy finances, mendacious promises and perhaps the intervention of the ratings agencies.

He still has a choice. He can be the prime minister who rescued the banks; or he can be the man who saved the banks but ruinously misled a nation. His electoral fate may be more or less decided. But his historical destiny is still in his hands.

Economist.com/blogs/bagehot

World food prices

Whatever happened to the food crisis?

Jul 2nd 2009
From The Economist print edition

It crept back

Still Pictures



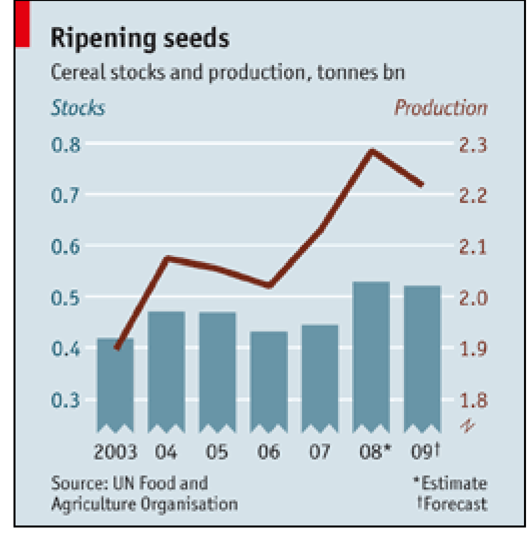
MULUALEM TEGEGN bought a donkey last year. As a hard-working Ethiopian farmer, aged 58, he saw the purchase of the beast as a return to better times after several seasons in which drought and high prices had forced him to sell his livestock and take his grandchildren out of school to work on the farm. This year, he will have enough grain left to buy a goat or two, and the donkey will help the children make the long trek again to school. This is how things are supposed to be.

World food prices soared in 2007-08, pushing hundreds of millions into poverty. But—said people at the time—there was a silver lining: high prices would be good for farmers, especially smallholders in poor countries such as Mr Tegegn. Higher returns would suck money into farming, leading to higher yields, bigger harvests and stable or falling food prices. Eventually, the argument ran, farmers and consumers would all be better off.

This happy state of affairs seemed to be coming to pass in the second half of 2008. Ethiopia reported a record cereals harvest this January, up 10% on the previous year. Across the world, the picture was similar. After the price spike in the first half of 2008, farmers harvested 2.3 billion tonnes of cereals in 2008/09, the biggest crop ever seen. Big exporters began lifting the trade bans they had imposed to keep local prices from rising, so more food became available to world markets. The sharp fall in the price of oil, which occurred at the same time, increased food supplies further because, by making oil cheaper than ethanol, it encouraged farmers to sell for feed the maize they would otherwise have turned into biofuels. As food supplies surged (and demand, hit by the global recession, stagnated), prices plummeted. Between its peak in July and a trough in December 2008, *The Economist*'s index of food prices fell by 40%.

All that seems fairly rational and hopeful. But this year's changes have been more puzzling. Between December and mid-June, the food index rebounded by a third, even though this year's total cereals crop is expected to be another bumper (2.2 billion tonnes, says the Food and Agriculture Organisation, second only to 2008/09, see chart left). Meanwhile, soyabean and sugar prices have risen by nearly half from trough to peak—see chart below—

and the index of "non-food agriculturals" (plants such as cotton or rubber) also rose by a quarter between December and mid-June. Prices have been increasing at a time of plenty.



It's not meant to go this way

If this was happening during a boom, it might be understandable. But recession would normally dampen down price rises. So what explains the return of food-price inflation? And does it mean that the so-called world food crisis is returning?

There are two clusters of explanation: cyclical factors—features of the farm cycle and world economy that fluctuate from season to season—and secular, long-term factors. Cyclical influences include re-stocking: cereal stocks were run down as prices spiked and need to be replenished. In 2006 and 2007, stocks fell below 450m tonnes, about 20% of consumption; now they are back up over 520m, or 23%. That is one source of new demand. Another comes from ethanol. As oil prices rise, ethanol starts to be competitive again (as a rule of thumb, ethanol is profitable when petrol costs $3 a gallon in America, a level it has just reached in California). The fall in the dollar and in freight rates has also kept the local-currency costs of importing a tonne of cereals lower than dollar-denominated world prices. This has encouraged many countries to buy more.

Lastly, it is possible that the widespread hunger brought about by soaring prices—the FAO says a billion people will go hungry this year—may have reached a peak and the poor may be back in the market for grain again. This may sound unlikely, as traditionally poor consumers have had little influence over world food prices, but economic growth has continued in the largest emerging markets (notably China and India) and governments in much of the developing world have been expanding aid programmes for the poor, such as conditional cash-transfer schemes. That may be boosting demand; it would explain why prices of grain, which everyone eats, have been rising this year while prices of meat—the food of the rich and aspiring middle classes—have continued to fall.

Snakes in the grass

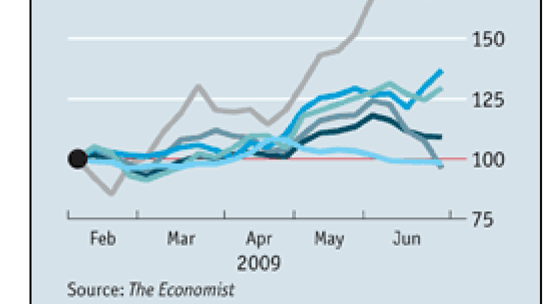
But the world food crisis of 2007-08 showed that food prices are not influenced solely, or even mainly, by cyclical factors. They soared in large part because of slow, irreversible trends: population growth; urbanisation; shifting appetites from grain to meat in developing countries. There is no sign that these trends are abating.

At the moment, the world's population is 6.7 billion and 750m people are born each year. Though the rate of increase is declining, inertia means the total will go on rising until 2050, when the population will reach 9 billion. In Ethiopia, for example, 18m children are born every year, rising to 24m a year by 2040. That will double its headcount from 80m to 160m.

The FAO reckons that, to keep pace, the amount of food available in developing countries will have to double by 2050, equivalent to a 70% rise in world food production. If that does not happen, fears Joachim von Braun, the head of the International Food Policy Research Institute in Washington, DC, there could be a return to the food conflicts of 2007-08 which caused riots in more than 60 countries and set off a controversial worldwide land grab—a rush by rich food-importers to buy swathes of Africa and South-East Asia on which to grow food. Even if the rise in output comes about but in the "wrong" way, there could be problems, since water in some areas is growing scarce and increasing food output will make it scarcer.

The right way, argues Alexander Mueller of the FAO, is for farmers in poor countries to boost their yields. This would be better for the countries themselves, since it would make them richer. And it would be better for the world, too, because the potential for higher yields should be greatest where they are now low, especially in Africa. At the moment, cereal yields in Africa are around one tonne per hectare, compared with three-to-four tonnes in Europe and rich Asia. It should be easier to get an extra

tonne per hectare by increasing African yields to two tonnes a hectare than by boosting already-fecund European or north-east Asian yields even further (water is more abundant in parts of Africa, too). Hence the hope that high prices in 2007-08 would goad farmers in poor countries to respond by increasing yields. Alas, there is little sign of that happening so far.



Losing out both ways

Almost all the increase in cereals output in 2008 came from rich countries: the harvest in those nations increased 11%. In developing countries, the rise was a mere 1%; if you exclude China, India and Brazil, grain output in poor countries actually fell. So while the costs of the food crisis bore heavily upon the poor, the benefits accrued more to farmers in industrialised countries. And nowhere were there signs that yields (output per acre) were rising. Harvests increased because farmers took more land under the plough.

The European Union shelved a programme that had obliged farmers to leave 10% of their land fallow; China scrapped a scheme that had allowed marginal arable to return to woodland. Both these actions boosted the amount of farmland. This was not bad in itself, and it was the quickest way to boost output. But it is only a first step. World food production cannot be increased by 70% just by increasing acreage: there is simply not enough unused land to go around.

The failure of farmers in poor countries to respond to price signals does not mean they are deaf to them. Rather the signals they get are often scrambled or muted. Farmers were frequently not paid the full world price for their crops, because governments were determined to keep local prices low in order to relieve hard-pressed consumers. Some governments also banned food exports.

Reuters



Off to a market that wobbles and wobbles

Even in rich countries, farmers are responding to many things other than food markets. Take oil prices, for example: these (and government subsidies) determine how much maize is planted for ethanol. That in turn influences how much land is planted to soyabeans, which for American farmers are interchangeable with maize. Growers are also responding to the flow of investment capital into farming as a result of the global financial meltdown. Food is recession-resistant, and farming has been one of the sectors least affected by the worldwide slump. The FAO's Abdolreza Abbassian argues that increasing links between farming and other parts of the economy are making it more difficult for farmers to calculate in advance the profitability of any one crop, so the area they plant is tending to fluctuate more sharply from year to year. Farming—as the past two years have clearly demonstrated—is becoming a more volatile business, both in terms of price and area planted.

On the face of things, markets last year were adjusting exactly as economic theory predicts they should: prices rose, drawing investment into farms; supplies then rose sharply, pushing prices down. But that was not the whole story. The price fluctuations of 2007-09 suggested that uncertainty in the world of agriculture was deepening under the influence both of oil prices and capital flows. The fact that prices are still well above their 2006 average, even in a recession, suggests that the spike of 2008 did not signal a mere bubble—but rather, a genuine mismatch of supply and demand. And this year's price increase suggests that there is a long way to go before that underlying mismatch is eventually addressed. "I don't see that anything has fundamentally changed," says Mr Abbassian. "That means we cannot go back to where we were in 2007."

Corporate tax

Escaping the shakedown

Jul 2nd 2009 | WASHINGTON, DC
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Governments are not raising corporate tax, but firms can no longer count on the taxman to treat them ever more kindly

Illustration by Claudio Munoz



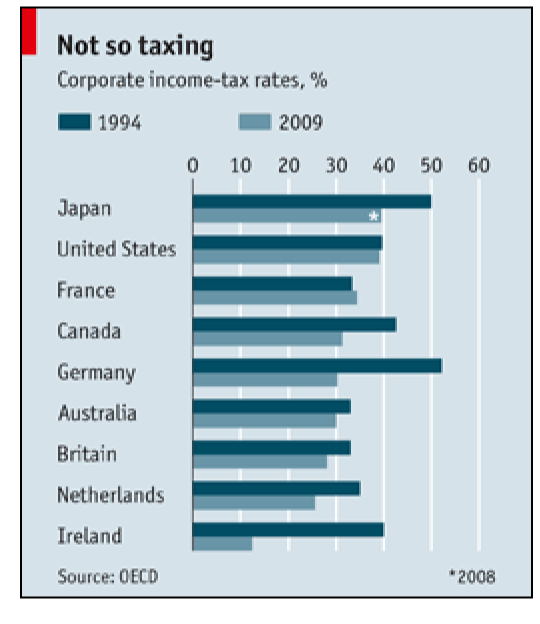
WHEN the Irish government, reeling from bank failures and a monumental property crash, unveiled an austerity budget in April, it socked individuals with higher taxes. But it left its corporate-tax rate—the lowest among OECD countries—unchanged at 12.5%. Last year Germany cut its corporate-tax rate from 39% to 30%. Canada is pressing ahead with plans to lower its combined federal-provincial rate to 25%. Russia has also reduced its corporate taxes, and Singapore intends to do so. According to the International Bureau of Fiscal Documentation (IBFD), an Amsterdam-based group that follows international tax developments, no country plans to raise its main corporate levy.

Despite spiralling budget deficits and the widespread belief that corporate greed precipitated the credit crunch, governments do not seem inclined to call on businesses to fill their empty coffers. Last August Japan, which has the OECD's highest corporate-tax rate, proposed exempting dividends paid to Japanese multinationals by foreign subsidiaries from tax, even as it planned, in effect, to raise more from individuals by increasing value-added tax. The dividend exemption came into force in April. In the same month Britain unveiled a budget that, like Ireland's, promised to clobber wealthy individuals but, like Japan's, exempted dividends paid by foreign subsidiaries from tax.

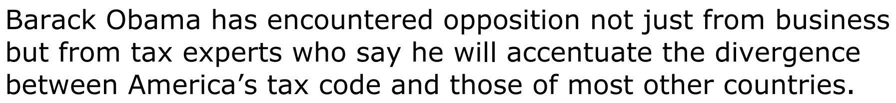
This forbearance is all the more remarkable given that corporate-tax rates in many countries are far lower than they were in the 1990s (see chart). Firms have also done well from stimulus packages: at least a dozen countries have offered them accelerated depreciation allowances or more generous tax-loss provisions, according to IBFD. Some governments are still trying to increase their appeal to foreign investors: Ireland is improving the tax treatment of intellectual property.

At the margins, however, the environment for corporations is shifting. Dali Bouzoraa, the IBFD's technical director, says the decade-old trend of lower corporate-tax rates is bottoming out, both because governments cannot afford further cuts and

because for some, going lower would turn them into tax havens, subject to punitive treatment by trading partners. What is more, countries are working harder to combat the shrinkage of their tax bases as more companies try to shelter profits abroad.



America has made by far the most determined attempt to defend its tax base. The Treasury proposes limiting the deductibility of expenses firms incur in America to support foreign operations that have paid no American tax. Its plan would also penalise companies that repatriate profit from places where taxes are high, like Japan, but not from places where they are low, like Ireland, by applying an average tax rate to all foreign income. Finally, the "check-the-box" option, under which companies can bury profits earned in tax havens in the accounts of other foreign subsidiaries, will be restricted.



Barack Obama has encountered opposition not just from business but from tax experts who say he will accentuate the divergence between America's tax code and those of most other countries. America uses a worldwide or tax-credit system for multinational firms, taxing their profits no matter where they are earned but allowing them credits for the taxes they pay to foreign governments. Multinationals can generally defer paying tax to their home governments by retaining profit earned abroad in their foreign units. Under the competing territorial or exemption system, a country taxes a company only on profits earned at home; dividends paid by foreign subsidiaries are exempt.

In theory, there is something to be said for both approaches: a worldwide system favours home country production over foreign production, whereas a territorial system favours the home country's multinationals over their foreign-based competitors. But globally, territorial systems are much more popular. Britain's and Japan's defection earlier this year leaves just five of the 30 OECD countries with worldwide systems (America, Ireland, Mexico, Poland and South Korea), according to Peter Merrill of PricewaterhouseCoopers. Mr Obama is "going in exactly the opposite direction" from the rest of the world, he says.

However, Mr Obama is setting the international trend in his attempts to crack down on corporate-tax avoidance, especially through tax havens, which were high on the agenda of the G20 summit in London in April. Australia is making it harder to obtain credits for tax paid in havens. Britain, as part of its reform, will limit the deductions multinationals can claim for local interest payments, to discourage them from shifting all their debts to Britain in order to minimise their tax. Even as it cuts its corporate-tax rate, Germany is limiting deductions for interest payments for highly indebted companies.

Mr Obama's campaign has a populist tinge. Many legislators have railed against the fact that American multinationals keep retained profit in units abroad (almost $1 trillion at the end of 2007, Mr Merrill estimates), beyond the reach of American taxmen. That is common with worldwide systems: last year Japanese companies had an estimated ¥17 trillion ($156 billion) stashed abroad in retained earnings. Yet when Senator John Kerry ran for president in 2004 he promised to crack down on tax avoidance by "Benedict Arnold" bosses. Mr Obama's rhetoric has been less purple but he too wants to remove incentives for firms to employ workers abroad instead of at home.

In practice the proposal's impact on jobs is not likely to be that great. Rosanne Altshuler, a tax expert at the Urban Institute, a think-tank, does not believe that making investment abroad more expensive will create more jobs in America. Steve Ballmer, the boss of Microsoft, has said that the proposal would even prompt his firm to move some jobs outside America. But Ireland fears the opposite: officials there are anxiously looking to see if the proposed changes will cause foreign investment to dry up. At the margin the proposals do seem to favour firms with headquarters outside America. But Tony Carbone, a tax lawyer at Bingham McCutchen, doubts any company will move as a result.

Whatever the proposal's impact on jobs, Mr Obama was doubtless also hoping that it would earn some money for his favoured causes, such as reforming health care. On that front, he is likely to be disappointed: a non-partisan congressional committee estimates it will raise just $159 billion over the next ten years, about $50 billion less than Mr Obama's budget had projected. Just how much firms will end up paying lawyers and accountants to help them comply with—or get around—the new rules is anybody's guess.

Foreign oil firms in Iraq

Waiting game

Jul 2nd 2009
From The Economist print edition

The Western giants hold out for a better offer

AP



What would a foreigner do?

FOR some conspiracy theorists, the war in Iraq was always about gaining control of the world's third-largest oil reserves for Western energy firms. True or not, things are not panning out that way. This week most big oil companies turned their backs on the first opening of Iraqi production to foreign investors since Saddam Hussein nationalised the industry 37 years ago.

The oil ministry, which wants to lift crude output from 2.4m barrels a day (b/d) last year to 6m b/d by 2017, hoped a much-delayed licensing round for eight of the country's biggest oil- and gasfields would bring international firms—with their capital and expertise—back to Iraq. But the televised auction proved embarrassing for Hussein al-Shahristani, Iraq's oil minister. Just one contract was awarded, to a joint venture between BP and China's CNPC, which beat a bid from Exxon Mobil and Petronas of Malaysia. That contract covers the Rumaila oilfield, Iraq's second largest. BP and its partner must now increase its output from 1m b/d to 2.85m b/d within six years. Their reward will be $2 a barrel, half the amount BP originally sought.

Oil firms balked at the miserly terms Iraq was offering for other fields. But Mr Shahristani claimed a moral victory from the auction, saying he had sent the oil firms a "message that there are people in Iraq who are protecting Iraq's wealth". That approach may win him support in parliament, where nationalists have accused him of preparing to sell the family silver. But according to Bill Farren-Price, an oil analyst at Medley Global Advisors, a consultancy, some companies may have stayed away from the auction in the belief that Iraq will soon have a new oil minister more sympathetic to their interests.

The reluctance to accept Iraq's terms also suggests renewed self-confidence on the part of big oil firms despite bruising encounters with resource-rich governments in the recent past. Among the giants ready to test Baghdad's resolve is ConocoPhillips, which was rumoured to want $26 a barrel to develop the 2.3-billion barrel Bai Hassan field.

Something will have to give. Foreign firms still have a tremendous thirst for oil like Iraq's, which is very cheap to produce and refine. And Iraq, with its widening budget deficit, has an urgent need to turn its riches beneath the ground into wealth above it.

A round of new negotiations between the companies and the ministry is likely. But obstacles remain. Iraq is still without an oil law, which undermines faith that contracts will be honoured. A deadly terrorist explosion in Kirkuk coincided with both the auction and the start of the withdrawal of American forces from Iraq's cities. An oil law may have to wait until after parliamentary elections next year. Security is an even more distant prospect.

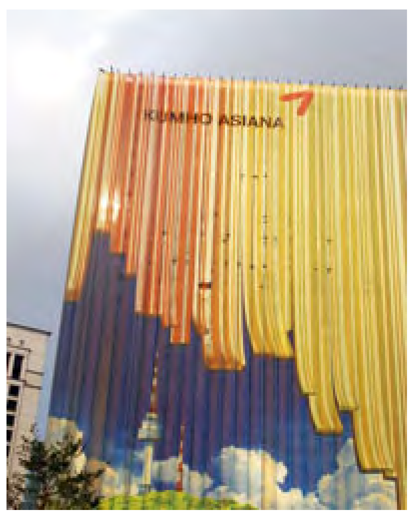
Restructuring South Korea's chaebol

A helping hand

Jul 2nd 2009 | SEOUL
From The Economist print edition

Is the government taking a hard enough line with indebted conglomerates?

Reuters



In the middle of a makeover

ON THE face of things, the restructuring of South Korea's heavily indebted family-owned conglomerates (*chaebol*) is proceeding apace. On June 28th the eighth-biggest, Kumho Asiana, said it would sell its one-third stake in Daewoo Engineering & Construction, one of its biggest units. Past governments have coddled *chaebol*, but the current one says free-market principles should prevail. Regulators say that they have been urging banks to take a hard line with nine struggling *chaebol*, including Kumho Asiana.

In addition to Daewoo, Kumho Asiana owns Asiana, the country's second-biggest airline, and petrochemical, tyre, life-insurance, resort and transport businesses. As with other *chaebol*, descendants of the founder still control the business. In 2008 it used its airline and Daewoo to become the biggest shareholder in South Korea's biggest logistics company, Korea Express. That acquisition, along with the purchase of Daewoo in 2006, has left it with debt of 15 trillion won ($11.8 billion). Moreover, the 18 South Korean banks and other investors that had bought almost 40% of Daewoo alongside Kumho Asiana are likely to exercise an option in December to sell the conglomerate their shares at a price of 31,500 won—over three times the level of June 26th. So Kumho Asiana needs to find another 4 trillion won.

The likely buyer of Daewoo is the state-owned Korea Development Bank. It has said it will create a special private-equity vehicle to that end. Several weeks ago it offered to buy Kumho Asiana's holding at a 30% premium to the market price. That would still leave Kumho Asiana about 1.7 trillion won short of its obligations under the put option, according to CLSA, a broker.

Korea Development Bank has also said that it will give Kumho Asiana the "right of first refusal" if it decides to sell the Daewoo stake. This idea has Seoul's financiers fuming. They do not see why the bank should be doing Kumho Asiana any favours. In its current form, they argue, its offer to buy the shares amounts to a bail-out. They note that Korea Development Bank is also in negotiations to buy a unit of Dongbu group, another indebted *chaebol*. They worry that the lender will end up impeding genuine restructuring.

But for all its talk of free markets, the government does not want any big *chaebol* to go bust. It is haunted by memories of the Asian financial crisis of 1997-98, when high corporate debt helped to sap investor confidence and spark a run on the won.

The irony is that most South Korean firms are in much better shape these days. They have cut their debt dramatically since the crisis and keep far more cash on hand. In December 1997 the average debt-to-equity ratio of firms listed on Seoul's stock exchange was 425%; in May this year it was 130%. Their cash reserves have risen from 10 trillion won in late 1999 to 78 trillion won at the beginning of this year. There are clearly plenty of South Koreans who have warmly embraced restructuring.

Corporate bankruptcies in America

The boom in busts

Jul 2nd 2009 | NEW YORK
From The Economist print edition

Bankruptcies are at near-record levels

IT IS not quite the Armageddon that was being predicted in the weeks after Lehman Brothers became America's biggest corporate bankruptcy last September. But this recession is still on course to be second only to the Depression in terms of companies going bust. Measured by the firm's assets at the time of filing for protection from their creditors, the past year has seen five of the eight biggest bankruptcy filings in the history of American business—with Washington Mutual, Thornburg Mortgage, General Motors (GM) and Chrysler joining Lehman on the list.

A good indicator of the awfulness of the downturn is the market for junk bonds, which surely deserve the name again after nearly two decades of attempts to rebrand them as safer-sounding "high-yield debt". At the end of May 9.2% of high-yield debt issues (globally, but dominated by American paper) had defaulted during the previous 12 months, compared with less than 1% in the year to December 2007. The failure rate is on course to hit 13.8% in the fourth quarter of this year, according to Moody's, a credit-rating agency, after which it should start to decline. That would be slightly higher than in the two previous recessions, when the percentage of defaults peaked at 10.9% (in January 2002) and 12.8% (in June 1991), but below the all-time high of around 16.3% in 1933.

Although they have wobbled a bit lately, junk-bond prices have recovered sharply in the past few months. This is particularly true of distressed issues (the ones trading at yields at least ten percentage points higher than those of Treasury bonds). In the fourth quarter of last year 87.5% of high-yield issues were distressed, which on past form implied an eventual default rate of more than 20% in the fourth quarter of this year, says Martin Fridson, of Fridson Investment Advisors. Now about 40% of issues are distressed, implying a default rate of 10% this time next year. According to JPMorgan, there were 15 defaults a month in the first four months of 2009, but the rate fell by half in May and June.

Not surprisingly, many prominent recent failures have been firms reliant on the American consumer, such as Eddie Bauer, a clothing retailer, and Six Flags, a theme-park operator. On July 1st Crabtree & Evelyn, a maker of soap and fragrances, filed for Chapter 11 bankruptcy protection. There is much speculation about possible bankruptcy for Harrah's Entertainment, a huge casino operator. Lear, a supplier of car parts, was expected to file as *The Economist* went to press.

The leading role of the federal government in the bankruptcies of GM and Chrysler has prompted fierce debate about the future of the Chapter 11 bankruptcy process. The government's proposals gave much less to some classes of creditors—including those who thought their debt was secured—than the usually strict rules of Chapter 11 dictate. This has prompted fury, lawsuits and talk of a slippery slope. Others argue that GM and Chrysler are exceptionally politicised.

Some courts are also giving bosses of bankrupt firms shorter shrift. On June 29th a bankruptcy judge ordered the executives of Gainey, a bankrupt trucking firm, to fly coach, "not first class, not business class. You'll travel like most of the rest of us do." At a bankruptcy hearing on July 21st for LyondellBasell, a petrochemicals giant, a judge will rule on a proposed $32m remuneration package for its putative new boss, James Gallogly.

What is clear is that law firms are doing very nicely out of corporate failure, as usual. The bill submitted by Jones Day for the first month of the Chrysler bankruptcy was for more than $12m.

Airlines in the recession

Running on empty

Jul 2nd 2009
From The Economist print edition

Lufthansa's unenthusiastic embrace of BMI is a sign of the times


Reuters



The summer rush

ON JULY 1st Lufthansa finally took control of BMI, the second-biggest carrier at Heathrow airport. But the only person celebrating was Sir Michael Bishop. A fortnight earlier the 67-year-old entrepreneur had forced the German airline to honour a decade-old put option to add his 50% stake to the 30% it already held, albeit at a lower price: £223m ($368m) rather than £292m.

That the deal had to be imposed on Lufthansa, almost literally on the steps of the High Court in London, was a sign of the times. Until quite recently, the chance to acquire BMI's 11% share of take-off and landing slots at Heathrow would have been enviable. In 2007 American airlines, eager to take advantage of new "open skies" rules, were paying up to £25m for each pairing of slots. But these days, faced with one of the most savage downturns in the history of a notoriously cyclical industry, Lufthansa is desperately trying to conserve cash and cut capacity to match plunging demand.

The airline recently warned that without fierce cost-cutting measures it would fail to make even an operating profit this year. In the first four months of 2009 its premium traffic fell by 15%, while traffic within Europe dropped by 37%. Blair Pomeroy, of Oliver Wyman, a consultancy, points out that the last thing Lufthansa needs just now is to spend precious money and management time trying to sort out a struggling, sub-scale airline such as BMI.

It shows just how bad things are if even Lufthansa, one of the world's most powerful airlines, cannot see how to make money by bulking up at Heathrow, one of the most coveted bits of real estate in aviation. According to IATA, the trade body that represents most of the world's airlines, the industry is on course to lose $9 billion this year. Although passenger volumes appear to have bottomed out and freight recently recorded a small increase, IATA's boss, Giovanni Bisignani, fears that the worst is yet to come and that once the summer holidays are over the crisis will intensify.

The problem, according to Brian Pearce, IATA's chief economist, is that "fares and yields are still collapsing" in most of the world because capacity cuts have yet to catch up with the fall in demand. Deliveries to airlines that ordered new planes near the top of the cycle are running at a rate of about 100 a month and will continue at that pace well into next year because the penalties for late cancellation are so high. It is also hard for airlines to mothball planes they are still paying for. American majors were able to slash capacity much faster than their European and Asian counterparts because many of their elderly planes were fully depreciated. In just a few months last year, United Airlines grounded nearly 100 of its elderly Boeing 737s.

Another anxiety is the price of jet fuel, which has risen by nearly 50% since the beginning of the year and by over 30% since early May. Mr Pearce says that his forecast assumes oil at $65 for the rest of the year—five dollars below the level it reached this week. Each extra dollar adds $1.6 billion to the airlines'

costs.

If cash continues to evaporate at its present rate, even the strongest airlines will need to raise money. But the price they will pay for it could cripple them for years. Even airlines with healthy balance sheets, such as American and Southwest, are having to pay 10-11% on secured debt. United offered a yield of 17% on $175m worth of debt issued last week.

Sir Richard Branson, the founder of Virgin Atlantic, has mischievously suggested that his old rival BA could go bust. Aviation analysts think that unlikely. But its chief executive, Willie Walsh, admits it is facing a "fight for survival". In the last financial year, BA recorded its worst-ever loss: £401m, £331m of which was chalked up in the first three months of 2009. The airline was getting through £2.7m a day in February and had cash reserves of less than £1.4 billion at the end of March.

Usually, about 65% of BA's profits come from its routes across the North Atlantic, most of it from passengers paying a £4,000 business-class fare to New York. So far this year, BA's premium traffic is down by about 17%—hardly surprising when much of it used to come from deal-chasing bankers. Mr Walsh is right to be fearful, particularly if unions balk at his plans to cut 3,500 jobs and opt to launch a summer of strikes.

IATA's Mr Pearce sees some signs of recovery in Asia. But he expects only a long, hard grind for airlines in Europe and America. European regional airlines, squeezed on one side by low-cost rivals like easyJet and Ryanair and on the other by the big network operators, such as Air France-KLM and Lufthansa, are especially vulnerable. Although overstretched by the acquisition of BMI and two smaller airlines, Lufthansa is strong enough to weather the storm better than most. But not as well as Sir Michael, who realised some time ago that the best way of making money from the airline industry was to leave it.



The recession spurs self-service

Help yourself

Jul 2nd 2009 | NEW YORK
From The Economist print edition

Customers are working for companies free of charge, and they like it

AMERICANS worried that cheap labour in faraway countries threatens jobs at home should redirect their gaze to the mirror. Yes, companies are outsourcing jobs—to their customers. They are steering ever greater numbers to ATMs instead of tellers, websites instead of telephone hotlines and automated checkouts instead of manned registers. The recession is making them even keener.

Self-service is on the rise in industries from retailing and entertainment to travel and telecommunications. According to VDC Research Group, retailing, hospitality and health-care firms spent $2.8 billion on self-service technology in 2008. Between now and 2013 their investment will grow by around 15% a year. Speech-recognition technology, which permits automated responses to telephone calls, is also faring well. Datamonitor Group, a consultancy, expects spending on that to rise by around 8% in 2009.

Firms that embrace self-service technology like to talk about the joys of "customer empowerment". Customers have grown increasingly used to self-service devices, whether they like them or not. A lot of consumers would still like to speak to a human being. But many people, especially younger ones who grew up with the internet, like doing things themselves. Gartner, a research firm, estimates that nearly 60% of customers prefer to check themselves whether an item is in stock at a store, often through a self-service kiosk or their mobile phone, instead of relying on an employee.

When done well, self-service can even increase customer loyalty. According to NCR, which makes self-service technology, 85% of consumers prefer brands that offer several forms of self-service: online, at kiosks and via mobiles, for example. Sometimes self-service can be more personal, not less. Many speech-recognition services store customers' information and greet them by name when they call. Companies that provide up-to-the-minute online account statements, including some mobile-phone and cable-television firms, appeal to those wanting to keep a close eye on their spending amid the recession.

The main reason why companies are so keen on self-service, however, is cost. On average, transactions performed through kiosks cost a tenth of what they would have had an employee handled them, according to Summit Research Associates, a consultancy. Comverse, a technology firm, reckons savings from online self-service can be even greater: it costs $7 to answer a query through a call centre, but only ten cents to deal with one online. Comverse says one of its clients deflects 200,000 calls a week through its online self-service portal, saving it around $52m a year. The savings come chiefly from replacing employees with machines, which do not require health benefits or a salary. According to Francie Mendelsohn, the president of Summit Research Associates, each self-service checkout at a grocery store replaces around 2.5 employees.

The extra convenience that self-service affords can also bring in new customers. Blockbuster, a video-rental firm, plans to set up 3,000 kiosks by the end of the year at supermarkets and convenience stores in order to reach people who do not come to its own stores. Pitney Bowes, which makes franking machines, has set up self-service mailing kiosks in shops and office buildings and is sharing revenue with the United States Postal Service, which is facing dramatic declines in mail volume. Pitney Bowes's research suggests that people who might otherwise not have bothered mailing packages or letters are now doing so.

The recession has made the savings from self-service especially welcome. Companies claim they do not fire employees but redeploy them to do more important work. But in a slow economy they are likely to get the boot. Self-service technology may provide other ways of helping companies through straitened times. Retailers, for example, are eagerly awaiting near-field communication (NFC) chips, which would store credit-card information in mobiles and so allow customers to use them instead of cards to make purchases. The technology would also help retailers keep track of customers' spending habits and advertise special offers. Brad Fick of Direct Source, which sells self-service technology, says NFC devices will be introduced in the next year or two. For retailers that last until then, that is good news.

Economist.com BUSINESS

Russia's dismal investment climate

Courting disaster

Jul 2nd 2009 | MOSCOW
From The Economist print edition

Legal and bureaucratic caprice is still undermining foreign investment

AP



Shelving investment

THE website of Telenor, a state-controlled Norwegian telecoms firm, has a special section dedicated to its investments in Russia and its dispute with Alfa Group, its Russian partner. It is a long and unhappy saga filled with headings such as "Geneva arbitration", "Court abuses" and "Black PR campaigns".

Telenor and Altima, the telecoms arm of Alfa, are shareholders in both VimpelCom of Russia and Kyivstar of Ukraine. In 2004 Altima, which wanted to expand its business in Ukraine further, suggested that VimpelCom buy another Ukrainian telecoms firm. Telenor resisted, saying that the price was too high. Altima accused Telenor of sabotaging its growth.

For several years the dispute rambled on, with several attempts at arbitration and suits and countersuits in various courts around the world. Then a company called Farimex entered the fray. It is registered in the British Virgin Islands and owns a 0.002% stake in VimpelCom. It complained to a court in Siberia that Telenor (which has no business in Siberia) had obstructed VimpelCom's entry into the Ukrainian market. The Siberian court ordered Telenor to pay compensation of $2.8 billion, a sum that was reduced to $1.7 billion on appeal.

When Telenor refused to pay, arguing that it had not exhausted its appeals, another court seized most of Telenor's 30% stake in VimpelCom. On June 19th Russia's bailiffs ordered the auction of the stake to raise the $1.7 billion. In most countries this would be called expropriation.

Telenor says it believes the Farimex case is connected to its dispute with Alfa Group. It believes that it could reach an agreement with Alfa, provided its troubles with Farimex come to an end. But Mikhail Fridman, the boss of Alfa Group, says it is not affiliated with Farimex in any way, although he supports its complaint.

Jens Stoltenberg, Norway's prime minister, has raised the subject of Telenor's dispute with Vladimir Putin, his Russian counterpart, who said the government was impartial. But as Telenor points out, Mr Putin himself has admitted that Russia's courts are unpredictable and are in urgent need of reform. It does not help that Russian state-owned firms have in the past benefited from judgments akin to those that Telenor is complaining about.

The clearest indictment of Russia's investment climate came a few days ago from IKEA, a Swedish retail chain, whose local operation has grown quickly since it opened its first store near Moscow in 2000. On June 23rd IKEA said it was suspending its investment in Russia because of the "unpredictable character of administrative procedures", a euphemism for graft. A symbol of Russia's economic rebound from the 1998 financial crisis has become an emblem of its dire investment climate.

Among 181 countries surveyed by the World Bank for ease of doing business, Russia occupies 120th place, below Nigeria. Transparency International gives Russia barely two points out of ten—its worst performance in ten years, which puts it on a par with Kenya. Until recently the Kremlin had no need to worry about things like property rights and the rule of law. Its oil wealth ensured an economic boom, no matter how it treated investors. Most of the money that flowed into the country came in the form of loans rather than foreign direct investment.

Now the loans have dried up. The Russian economy is forecast to contract by 8.5% this year, an especially dire performance by the standards of the so-called BRIC countries (the others are Brazil, China and India). Russia still blames the global economic crisis for its misfortunes. A closer look at IKEA and Telenor, as well as many of Russia’s own companies, suggests the truth is more complicated.

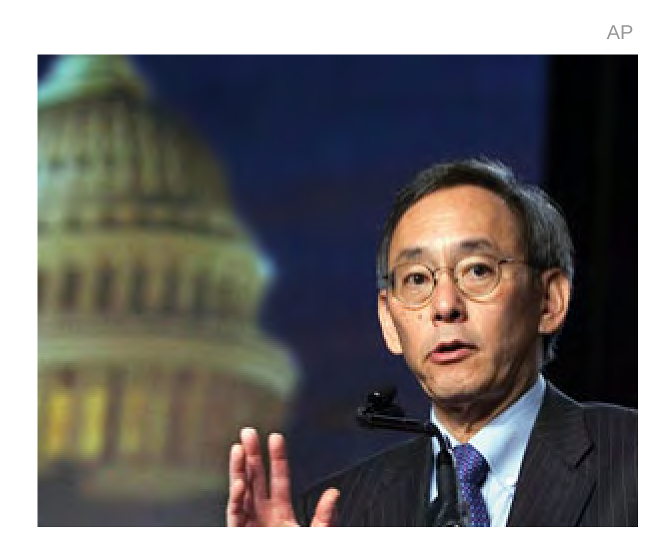
Face value

The alternative choice

Jul 2nd 2009
From The Economist print edition

Steven Chu wants to save the world by transforming its largest industry: energy

AP



WHETHER Steven Chu, America's energy secretary, would be flattered or horrified by the comparison is unclear, but he and Margaret Thatcher have something important in common. They are both scientists who have risen to political power. That Mr Chu has a Nobel prize for physics, whereas Lady Thatcher swiftly abandoned chemistry for the more lucrative pastures of the law, does not make the comparison unfair. What matters is that both of them understand something that some politicians from softer intellectual backgrounds often seem to forget: you cannot negotiate with nature. Nor can you ignore it, for it will not go away.

Lady Thatcher showed her mettle in this regard in 1989, when she became the first politician of stature to raise the alarm about global warming. When her adviser Crispin Tickell pointed out to her that the level of carbon dioxide in the atmosphere was rising and that carbon dioxide was a greenhouse gas, she got the point instantly and alerted the world in a speech to the United Nations. Mr Chu's job is harder: he is charged with spotting, nurturing and promoting promising energy technologies, thereby helping America to create the tools that the world needs to wean itself off fossil fuels.

He certainly has the qualifications to do so. Barack Obama poached him from the Lawrence Berkeley National Laboratory, which he had directed since 2004, and which he was busy shaping into a centre for the study of alternative energy. He had, for example, negotiated a $500m deal with BP, one of the world's biggest oil companies, to base its Energy Biosciences Institute there.

He is also a man who thinks big. While Mr Chu was at Berkeley, he conceived the idea of a global "glucose economy", to supplant mankind's dependence on oil. Fast-growing crops would be planted in the tropics, where sunlight is abundant. They would be converted into glucose (of which cellulose, which makes up much of the dry weight of a plant, is a polymer) and the glucose would be shipped around much as oil is today, for eventual conversion into biofuels and bioplastics. That idea might not go down well with energy nationalists, who want America to declare independence from all hot and unreliable countries, whether oil producers or agricultural powers, but it shows vision on the scale needed to deal with global warming.

Another example of his unorthodox thinking is his observation that painting the roofs of buildings around the world white and using light-coloured road surfaces rather than blacktop would reflect a lot of sunlight back into space—possibly enough to have an effect on global warming as big as taking every car in the world off the road for a decade. There are plenty of scientists with such notions, but they are seldom in a position to convert their visions into reality.

That, of course, requires money. Fortunately, Mr Chu has it. Besides his department's annual budget of $26 billion, he has got his hands on $39 billion of the stimulus package. So he is able to spend like a drunken sailor when he chooses. On June 24th, for example, he announced that Ford would receive a loan of $6 billion to make its petrol-powered cars more efficient, while Nissan and a small Californian firm called Tesla Motors would get loans of $2 billion and $465m respectively to push forward with electric cars. On June 25th he followed this up by saying that $3.9 billion would be made available for revamping the American electricity grid. Building a "smart grid" is an important part of his plan. It will let wind and solar power be transmitted to the cities, and smooth out peaks and troughs in demand—for example by feeding power to the batteries of parked electric cars at night, and sucking it out of them during the day, if their owners agree.

It is not all largesse, though. The budget for hydrogen-powered vehicles, once the darlings of the alternative-energy lobby, has been slashed. Mr Chu does not believe in them. The long-awaited Yucca Mountain nuclear-waste dump has also been axed. He reckons the existing system of local storage is good for a few more decades and is looking into an old idea for dealing with nuclear waste: "burning" it in special reactors that will transmute it into more benign elements, thus eliminating the objection that nuclear power simply dumps the problem of waste in the laps of future generations.

It has not, of course, all been plain sailing. Mr Chu has little role in shaping the most important element of America's energy policy, the law on climate change now wending its way through Congress (see article). The Department of Energy's main job is to spend the generous sums Congress has allocated it—yet until recently it had been very slow to do so (see article). And in the shark-infested waters of Washington, Mr Chu's forthright pronouncements on energy policy, which have not always conformed with Mr Obama's views, have prompted a feeding frenzy.

On top, not on tap

For decades, the civilian side of the energy department pottered along quietly. Oil, coal and gas were familiar to the point of boredom, and no new nuclear plants were being built (the department also looks after nuclear weapons, but that is another matter). Wags used to say that the one essential qualification for being energy secretary was not to know anything about energy. That was what advisers were for. As no less a politician than Winston Churchill put it, scientists should be on tap, not on top.

Ideally the development of low-carbon technologies would be left to the market, encouraged by a suitable carbon price. But Congress has entrusted much of the work to Mr Chu's department, and given that many of the choices it confronts are scientific and technological, it helps to have someone who knows the subject in charge. If he can help communicate the immutability of natural laws to America's almost equally obdurate politicians, then on top, rather than on tap, is where he deserves to be.

Economist.com OPINION

Private schools in the recession

Staying on board

Jul 2nd 2009 | LONDON AND NEW YORK
From The Economist print edition

In both America and Britain recession has so far done little to dent the demand for private education

Illustration by M. Jeeves



"COMPARED with last year, applications are up 14%," says Mark Stanek, the principal of Ethical Culture Fieldston, a private school in New York. All through the application season he and his board of governors had been on tenterhooks, waiting to see if financial turmoil would cut the number of parents prepared to pay $32,000-34,000 a year to educate a child. Requests for financial help from families already at Fieldston had been rising fast, and the school had scraped together $3m—on top of the $8m it spends on financial aid in a normal year—in the hope of tiding as many over as possible. Nothing is certain until pupils turn up in the autumn. Some parents could get cold feet and sacrifice their deposits. Yet so far the school is more popular than ever.

Across America the picture is patchier, but there is little sign of a recession-induced meltdown in private schooling. Catholic parochial schools and some in rural areas are finding the going harder—but this is merely the acceleration of existing trends. Private schools in big cities with rich residents, and those with famous names and a history of sending graduates to the Ivy League, seem to be doing rather well. "Some parents weighing up their options may be worried about what recession will do to public-school budgets," says Myra McGovern of the National Association of Independent Schools (NAIS), which represents around 1,400 of the country's 30,000-odd private schools. "And some may think that if other people are struggling, that will mean their children are more likely to get in."

In Britain the story is similar. "Requests for financial help do seem to be up," says David Lyscom of the Independent Schools Council (ISC), which represents 1,280 private schools, including most of the long-established ones. "In the long run we may see some smaller schools merge in order to gain economies of scale. But pupil numbers are steady and head teachers are saying parental interest remains high."

At first sight, private schools' seeming immunity to recession is odd. Fees have risen faster than earnings in both countries for many years and have doubled in real terms (ie, after adjusting for consumer-price inflation) in the past quarter-century. The average price of a year at an ISC secondary day school is more than £12,000 ($20,000). The parents of 12th-graders at an NAIS establishment can expect to pay something similar. Many of the professionals who used to be natural customers have been priced out.

So schools have become more reliant on parents who work in financial services, an industry which has taken a beating. The recession has made it harder for parents to raise cash from sources other than

earnings. Falling house prices mean less equity to raid. Anyway, there is a mortgage drought. Low interest rates make it harder to fill the gap from investments, either parents' or grandparents'. At least stockmarkets have been rising in recent months.

But any notion that fees will decline in line with ability to pay is wishful thinking. Few private schools are intending even to freeze fees. Their precise plans are hard to divine, because in recent years antitrust regulators in both countries have made schools wary of publicising planned fee increases until all have set fees and told parents. (Signalling them sooner, competition authorities believe, could facilitate collusion.) But a straw poll suggests that many will raise fees this autumn by 2-4%.

That is because, despite some parents' pleas for financial help, schools are under little pressure to cut fees. In both America and Britain income inequality is high by rich-world standards, especially at the top end, so there are people who can pay for the most illustrious schools with little or no pain. Further down the income scale, parents with children already at school do all they can to keep them there, even if it hurts financially. And despite the incumbents' high and rising prices, schooling is an industry in which it is remarkably hard for new entrants to establish themselves. Reputation—in particular, a name for providing a way into leading universities—is what counts. By definition, a newcomer cannot offer that.

Past experience bears out the resilience of private schools in hard times. It has taken several years for previous recessions to affect demand. Eventually, some whose confidence has been bruised by recession decide not to buy in at all. Some, but not many. Britain's most recent recession, in 1991-92, dented total enrolments in ISC schools by only 2.4%. The trough did not come until 1996, by which time the recession was a distant memory, and numbers recovered soon after. The most famous and expensive institutions rode out the bad times best. The 250 confusingly named "public" schools in the Headmasters' and Headmistresses' Conference saw rolls fall only in one year, and by a mere 0.5%.

Palaces of learning

No one knows how many children are privately educated worldwide: many private schools are invisible to officialdom; some are in slums. James Tooley, a professor of education at Newcastle University, has found many children at fee-charging schools in Africa, China and Latin America. The elite institutions of popular imagination are far from representative of private education more generally.

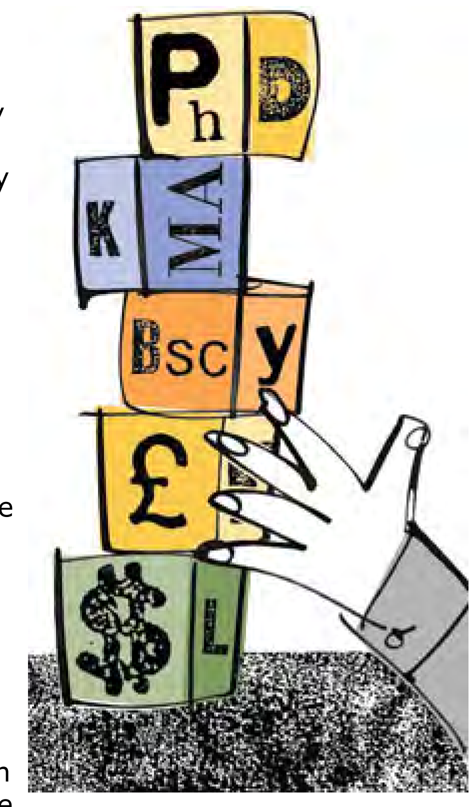
Yet in a few places such schools exert an influence out of all proportion to their share of pupils. In Britain only 7% of children are educated privately at any one time. Yet according to the Sutton Trust, an education charity, two-thirds of leading judges and barristers, half of well-known journalists, the chief executives of half the companies in the FTSE 100 index and a third of MPs attended private schools.

A private education is widely seen as the way to move up a class or three. When Jade Goody, a 27-year-old Briton who travelled from unpromising origins to stardom via reality television, found out earlier this year that her ovarian cancer was terminal, she sold the spectacle of her final days to the highest bidder, for her sons' sake. "If I earn enough money while I'm sick there will be enough for them to go to private school until they are 18," she explained.

In America around 11% of children are privately educated, a figure that is greatly boosted by the country's strict separation of church and state. Although no school has the history of, say, the King's School, Canterbury, or Wells Cathedral School (two English public schools both well over 1,000 years old), institutions such as New York's Ivy Preparatory School League (of which Fieldston is a member) or Phillips Exeter in New Hampshire, which has an endowment of more than $1m per student, have similarly gilded reputations.

Illustration by M. Jeeves

But it is not only history or money that gives these schools their privileged place. In both America and Britain the gap in performance between state and private education is wide. (Canada has "public schools" along English lines, but its state schools do very well in international comparisons, making it harder for private ones to shine.) The cities where the rich live have particularly poor state schools—in some inner London boroughs, a quarter of children or more are privately educated. Above all, America and Britain are home to the world's most prestigious universities. The first university from another country in the *Times Higher Education* ranking comes in at number 16; in the Shanghai Jiaotong ranking, at number 19.



The main commodity that elite schools in the two countries are selling is an edge in university admissions—a commodity that matters as it does nowhere else. In America, private schools offer knowledge of the ins and outs of selective universities' admission methods, and carefully cultivated relationships with their admissions tutors. In England more than two-fifths of the students at Oxford and Cambridge were privately schooled; each year, the two universities admit more boys from Eton than from the country's entire pool of lads poor enough to get free school meals.

That the schools know this is their main purpose is clear from the prominence of the university destinations of alumni in prospectuses and on websites. Parents know it too. Last year, for the first time anyone could remember, Dalton, another member of the Ivy Preparatory School League, failed to send a single student to Harvard. It made headlines. "The school took its eye off what it's supposed to be about," a parent told reporters.

When challenged by parents, head teachers can readily say what the ever-rising fees are spent on. Between two-thirds and three-quarters goes on staff pay, which has been rising faster than consumer prices. Increasing amounts go on financial aid for poorer pupils. And schools meet little resistance from customers because a private education is painful to abandon part way through. Children who are pulled out often end up at the state schools no one else wanted, because the others are full. As long as fees do not go up unbearably in any one year, parents, like frogs in slowly boiled water, stay rather than jump.

Nor can new competitors easily creep in and undercut incumbents. In big cities, where people want private education most, property is scarce and dear, and local officials are obstructive. "Planning departments put all sorts of obstacles in your way," says Robert Whelan of Civitas, a think-tank that runs three rare low-cost "New Model Schools" in London. (Fees, at just over £5,000, are little more than half the average for private day schools in the capital.) "They seem to care more about their traffic plans than anything else."

As for kitting out a school to compete at the luxury end of the market, the expense puts off all but a few. Claremont Preparatory School is a rarity: a new school in Manhattan. Housed in a former bank building, it has an indoor swimming pool and basketball court, a rooftop adventure playground overlooked by the stock exchange, a ballroom-sized auditorium on the former trading floor, and much more. After four years, it is in the black on running costs, but the upfront investment was huge. "It cost $28m just to open the doors," says a spokeswoman for the school. "Michael Koffler [the owner] will make a profit, but no time soon."

In 2001 MORI, a British pollster, asked parents with children at private schools why they had made their choice. Eight in ten said reputation had been very important. That is understandable, because the quality of education cannot be checked until after it is consumed. But it further entrenches incumbents—as does the need for schools to show parents a track record of admission to elite universities. "We will only recommend schools that have at least a decade of history behind them," says Amanda Uhry, the owner of Manhattan Private School Advisors, a company that helps parents choose schools and get their children in.*

With such high barriers to entry, it is unsurprising that most purveyors of elite education are old, and many are charities. But far from charitable status keeping fees down, some think it is one reason they have soared. Anders Hultin, a founder and former chief executive of Kunskapsskolan, a for-profit company that runs 32 schools in Sweden and is trying to break into the English market, ascribes the success of his home country's "voucher" reforms in the 1990s to allowing such schools to be run for profit. The share of Swedish children educated privately but at the state's expense grew from negligible to around 12% in just 15 years. "Without the profit motive, private schools just become choosier about whom they admit, rather than expanding or opening new schools," he says. "I sometimes think non-profit schools should be banned."

The hole in the middle of the market

Every now and then a company or charity promises to blow the schools market wide open by charging around the same as the state spends on each child, but to better effect. Such promises rarely come to much. Not only is the private competition well set, but the fact that state schooling is free at the point of use makes cheap-to-middling schools hard to sell. Parents might grumble at what the state provides, but unless it is worth almost nothing, most will balk at paying all over again out of taxed income. More efficient, they will think, to top-up with private tutoring. This is the norm in Japan, say, where state schools are generally good enough for parents not to turn their backs on, but university admissions are increasingly competitive.

When cheap private schools do succeed, it is often because they find parents who think state education is valueless: fans of Montessori or Steiner, or people who refuse to send their children to godless institutions. Such schools may even spend less than the state, and some British Islamic schools much less. The New Model Schools squat in church halls and the like while seeking permanent homes, yet have long waiting lists. Parents are mostly of modest means, but desperate. “They care passionately about education and are not happy with the poorly performing state schools that would be their only alternative,” says Mr Whelan.

Even for those with higher incomes, the existence of a free competitor reduces demand. Last year MTM Consulting, a British education-research company, asked rich families that did not use private schools: why not? Many said they could not afford it, or it was not worth it. Many choose instead to buy a house near a nice state school. The cost can be recouped by selling once the children are grown.

If a school were to attract these people by cutting frills and squeezing fees it might not please the customers it already has. In MORI’s poll, price came low among parents’ reasons for choosing a school. Small classes, individual attention and fancy facilities—all unavoidably expensive—were at the top. For some, elite education is a “Veblen good”, named after the economist who noticed that a high price was part of the value of luxury goods. “If things don’t turn out the way parents hope, they want to know they have done everything possible for their child,” says the headmaster of one venerable English day institution, when asked what exactly his school offers that is worth £16,000 a year.

Illustration by M. Jeeves



Indeed, for the most prestigious schools at least, the puzzle is not why they are so expensive, but why they are so cheap. The existence of companies like Manhattan Private School Advisors—which charges parents $18,500, non-refundable, to help them apply for school places—suggests that some schools’ fees are well below the market-clearing rate. Other signs are colossal waiting lists, onerous application procedures and the expectation that children are already at a high standard. Though the last is billed as ensuring that only pupils who can benefit are admitted, it can also be read as a requirement that customers do much of the schools’ job in advance.

So why aren’t fees even higher? Sheer embarrassment may be one reason. Non-profit (or charitable) status is hard to defend with a straight face if fees are outrageously out of line. A more likely explanation, though, is that schools’ quality would decline if they simply sold places to the highest bidders. Part of what they offer is the chance to learn with clever classmates, and if fees were too high the pool of brainy potential pupils would become too shallow. Schools with stellar reputations have some room before their fees pass the point at which too few clever children apply.

The recession will no doubt cause some pain to some private schools: the less prestigious, the badly managed and those that have relied on high returns from big endowments. If bonuses never return, or income inequality falls markedly for some other reason, even the elite could find the going harder. Pricing by ability to pay, already normal at American universities, may become more common, and could be given a shove by schools with a lot of parents struggling to find the fees. A dramatic change to the free competition would also have a big effect. The one part of the United Kingdom where private education is almost unknown is Northern Ireland, which kept academically selective state grammar schools when a Labour government abolished them almost everywhere else (although they are now under threat).

In truth, the future of elite schools in both countries depends less on the government, or even the global economy, than on the elite universities that are the main reason that they have flourished. That

America's have travelled much further down the road to price differentiation than Britain's can be seen as a reflection of differences in university admissions.

Admissions officers at selective American universities put enormous effort into creating "balanced" classes—by which they primarily mean a mix of races and parental incomes. So in the game of selling past pupils' university offers to prospective parents, prestigious schools can attract full-price customers by offering a scattering of scholarships to the poor and non-white, non-Asian children whom universities are likely to favour.

In Britain, by contrast, attempts to offer scholarships to poor children tend to be characterised as "robbing" state schools of their brightest students. And the discussion of diversity in university admissions centres neither on race nor on riches, but on where students went to school. That means any direct attempt to increase diversity in universities poses a direct threat to private schools' main selling point.

To see how serious that threat could be, consider Laura Spence. In 2000 Ms Spence, a clever state-school pupil, was rejected by Magdalen College, Oxford, where she had applied to study medicine. Never mind that the college had 22 applicants for five places, or that it took other state-school pupils: Gordon Brown, now prime minister, then chancellor of the exchequer, called her rejection an "absolute scandal". It kicked off years of political sabre-rattling.

Before the Spence affair, the number of 17-year-olds in private schools—ie, pupils starting A-levels, the exams used for university entrance—was 89% of the number of 16-year-olds. Since 2002 that ratio has fallen to 85%, as some parents shied away from displaying their child's private education to universities. A small change? Maybe. But a few intemperate words from one powerful politician had almost twice the impact of Britain's last big recession on demand for private schooling.

An interview with Ms Uhry can be heard here

Appraising the European Central Bank

Hard talk, soft policy

Jul 2nd 2009
From The Economist print edition

The ECB has run as loose a monetary policy as other central banks have. It is just rather more coy about it

Illustration by S. Kambayashi



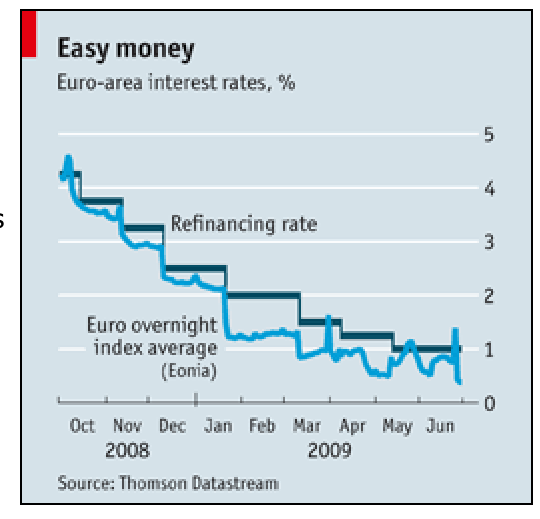
THE global economy has stopped sinking and central bankers are pausing for breath. As *The Economist* went to press on July 2nd, the European Central Bank (ECB) was expected to keep its main "refi" interest rate unchanged, at 1%. The ECB's rate-setting council has been chary of cutting rates closer to zero as policymakers elsewhere have done. Its reluctance to do more has attracted criticism, only some of it fair.

The focus on policy rates may put the ECB in a bad light but these are no longer a reliable guide to the overall monetary-policy stance. If you look at market rates the policy stance in the euro area is as loose as anywhere else, because of stimulus decisions taken at the height of the financial crisis. In October the ECB decided it would offer banks as much cash as they wanted, at a fixed interest rate (the refi rate) and against a wider range of security than usual, for up to six months. It also scheduled extra three-month and six-month refinancing operations, so that banks could come more often to the central-bank well.

In May the ECB council agreed to extend the offer of fixed-rate cash to one year. At the first 12-month refinancing operation on June 24th, euro-zone banks borrowed a staggering €442 billion ($620 billion). With so much cash splashing around, the charge that banks make for overnight loans has stayed well below the refi rate, with some occasional spikes (see chart). Since the €442 billion cash injection, overnight interest rates in the euro zone have fallen to a record low of 0.3%, below those in Britain and scarcely higher than in America. Indeed banks can now borrow more cheaply in euros than in pounds for either three, six or 12 months.

Before the crisis, the ECB would aim to keep overnight interest rates close to the refi rate. Since it moved to unlimited fixed-rate funding, the central bank has been content to allow the overnight rate to drift much lower than the policy rate. In effect, the bank now has a target range for short-term rates: the upper bound is the 1% refi rate and the lower bound is the rate the central bank pays on banks' deposits with it, currently 0.25%. The deposit rate has been a better guide to the policy stance than the refi rate

has. ECB-watchers and markets understand this, even though it has not been spelt out in so many words by Jean-Claude Trichet, the ECB's president.



Why be so coy? One concern is that by playing up the fight against recession, the ECB could appear to have lost sight of inflation. Keeping the totemic refi rate above zero may be seen as necessary to prevent inflation expectations from drifting up. There may also be a reluctance to admit that such a gushing provision of liquidity has altered the policy stance. Since the start of the crisis in August 2007, the ECB has insisted the two are separate. "They are bold on liquidity because they don't see it as mainstream monetary policy," says Charles Wyplosz of the Graduate Institute in Geneva. Yet the terms of its refinancing for banks have clearly led to looser monetary conditions.

Another reason for obfuscation is to mask differences among rate-setters. Monetary-policy hawks can reassure themselves that the policy rate is not too low. Doves are happy that effective interest rates are nearer to zero. And Mr Trichet can claim there is a "consensus". The terms of the truce make it easier to reverse policy when the time comes. By restricting its liquidity support, the ECB will be able to guide overnight interest rates towards 1% without having to alter its policy rate.

Because the ECB has had one eye on the exit since the start of the crisis it has earned plaudits from those who think the Federal Reserve has been incautious. That judgment is too kind to the ECB, which could afford to have scruples about the medium term because other central banks were taking more care of the present. It is also unfair on the Fed, which had to stand in place of America's collapsed shadow-banking system. When the economy was in most danger, the ECB could have cut rates more quickly. "If the ECB had been more proactive, the recession would have been less bad," says Marco Annunziata of UniCredit. The striving for consensus militated against bolder action.

Another criticism is that the ECB has not done more to ease credit conditions by buying government and corporate bonds outright, as the Bank of England and the Fed have done. Its scheme to purchase up to €60 billion of the safest bank bonds, launched this month, is modest by comparison. Mr Trichet believes that focus makes sense, as euro-zone businesses and homebuyers rely more on banks than capital markets for credit. In America, capital markets matter more, so the Fed had to get its hands dirtier by buying commercial paper and mortgage-backed securities.

The ECB is also loth to soil its hands with public debt, though banks flush with central-bank cash are keen buyers of such low-risk assets. If this is monetisation at a remove, so be it. The central bank keeps its independence from government and does not have to worry about selling bonds back into the market once the interest-rate cycle turns. "If you want to stay clean, the exit strategy is easier," says Thomas Mayer of Deutsche Bank.

But offering ample liquidity support to banks gets you only so far. By buying assets, the Fed allows American banks to shed them, freeing scarce capital for fresh lending. As losses mount in the euro zone, capital may trump liquidity in determining credit growth. Lending to the private sector slowed to 1.8% in the year to May, an all-time low. Until credit starts to revive, the ECB cannot think about tightening policy. It may yet have to be bolder.

Buttonwood

Caveat creditor

Jul 2nd 2009
From The Economist print edition

A new economic era is dawning

Illustration by S. Kambayashi



SOMETIMES you can have too much news. There was so much financial turmoil in the autumn that it was hard to keep up with events. In retrospect it is clear that a change in the economic backdrop akin to the demise of the Bretton Woods system in the early 1970s has taken place. Investors will be dealing with the aftermath for decades to come.

From the mid-1980s onwards the answer to big financial setbacks appeared to be simple. Central banks would cut interest rates and, eventually, the stockmarket would recover. It worked after Black Monday (the day in October 1987 when the Dow Jones Industrial Average fell by 23%) and the Asian crisis of 1997-98. It did not rescue shares after the dotcom bust but the easing led to the housing boom and the underpricing of risk in credit markets.

Easing monetary policy was pretty popular. It lowered borrowing costs for companies and homebuyers. To the extent that savers earned lower returns on their deposit accounts, they were usually compensated by a rebound in the value of their equity holdings.

Indeed, monetary easing appeared to be costless. When policymakers cut interest rates in the 1960s and 1970s they often ignited inflationary pressures. Not so in the 1990s. Whether that was down to the brilliance of central banks or the deflationary pressures emanating from China and India is still a matter of debate.

This time around conventional monetary policy has not been enough. The authorities have also had to resort to quantitative easing, using the balance-sheets of central banks to ensure the funding of clearing banks and to keep the lid on bond yields. And there has been a huge dollop of fiscal easing. Some countries' budget deficits have soared to 10% of GDP.

The fiscal packages have proved rather less popular than monetary easing. Initially they were seen as bail-outs for greedy bankers. But the focus of criticism has shifted to the deterioration of government finances and the potential for higher future taxes, borrowing costs and inflation.

An eerie parallel seems to be at work. There was a time, back in the 1950s and 1960s, when Keynesian stimulus packages were seen as costless. Governments thought they could fine-tune their economies out of recession. Eventually it was realised that the ultimate result of too much stimulus was higher inflation and excessive government involvement in the economy. Keynesian demand management was abandoned in favour of the monetary approach. The past couple of years have demonstrated that the use of monetary policy had its costs too, not in consumer inflation but in rising debt levels and growing asset bubbles.

The authorities never even considered allowing the financial crisis to continue unhindered. The damage to the economy would have been too great. But the costs of this latest round of government action will be big. Investors will have it in mind during the next boom that governments will rescue the largest banks, slash rates, intervene in the markets and run huge deficits. In other words the moral-hazard problem will be even greater.

Before we get there, however, the authorities will have to work out an exit strategy. Past cycles have shown that the tightening phase, after a long period of low rates, can be very dangerous. Bond markets were savaged in 1994 when the Federal Reserve started to raise rates from 3%. What will bond markets

do if central banks also unload the holdings acquired during the crisis? And how will stockmarkets perform if interest rates and taxes are being raised at the same time?

Given these risks, the new era will surely be a lot more fragile than the one that prevailed in the 1980s and 1990s. There is simply more scope for policymakers to go wrong.

In addition, the global financial system has lost its anchor. When Bretton Woods broke down and the last link to gold was severed, there was in theory nothing to stop governments from creating money. It took independent central banks, armed with inflation targets, to reassure creditors. But now central banks have shown they have another priority apart from controlling inflation: bailing out the banks.

The new era is one in which governments are using floating exchange rates, near-zero interest rates and vast fiscal deficits to protect their economies. None of this is good news for creditors, who will surely not put up with the situation for long. The actions they take to protect their portfolios—demanding higher bond yields, pushing for fixed exchange rates—will define the next economic system.

Economist.com/blogs/buttonwood

Japanese banking liberalisation

Knocking down the wall

Jul 2nd 2009 | TOKYO
From The Economist print edition

Japan eases the rules for banks and their securities affiliates

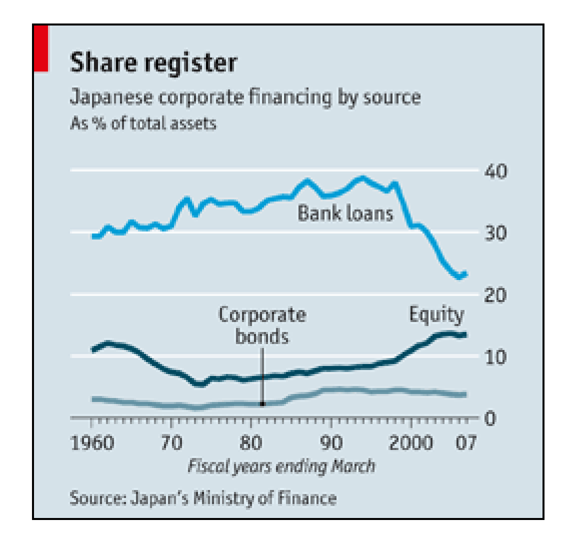
REGULATORS around the world are contemplating higher walls between commercial banks and their investment-banking divisions. In Japan the opposite is happening. Last month the country's Financial Services Agency (FSA) dramatically eased the regulations on how banks may interact with their securities arms, with sweeping implications for Japan's financial markets.

The old system laid huge burdens on financial groups. It prevented bankers from suggesting services that were provided by the same firm but housed in a different unit. Foreign banks, lacking the same holding-company structures as domestic rivals, were the worst hit. Until recently, grouses an employee of a big bank, its Japanese unit generated more paperwork than the rest of its operations across Asia combined. Domestic firms also suffered. And a system designed to minimise risk increased it, says an executive. "If the country manager asks the head of the securities unit, 'How's business?', he can't say because he is in a different legal entity."

The new rules simplify things. The reform allows employees to work across different units. So support staff can perform tasks for both the banking and securities units, which should increase efficiency, lower costs and improve risk management. It also lets employees cross-sell products, provided that a robust system exists to prevent conflicts of interest. Previously, corporate customers had to opt in to enable the banking group to share client information. Now they must opt out.

The new responsibility placed on companies to monitor themselves partly explains harsh sanctions that have been handed down by the FSA recently. Hapless Citigroup's bad run continues: it has been barred from promoting its retail bank in Japan for a month, starting in mid-July, because of inadequate controls on money-laundering. And Mitsubishi UFJ Financial Group, a huge local bank, was slapped with sanctions for failing to prevent data theft by a fired employee.

The reform is intended to unleash more sophisticated financial products in Japan. Regional lenders and the country's three "megabanks" exert enormous power over companies. Firms tend to rely on bank loans rather than the capital markets for their financing even though the level has decreased since the 1990s banking crisis (see chart). Japanese firms are three times more reliant on bank lending than American firms are. Relationships that span decades are hard to unwind but even the banks recognise that the capital markets need to develop.



The new rules also let the megabanks compete a bit more easily in the securities business, which is dominated in Japan by Nomura. It handled about half of all financing deals in Japan last fiscal year, and 95% of the deals so far this year. New rivalry at home partly explains Nomura's interest in looking abroad for growth by acquiring the European and Asian investment-banking arms of Lehman Brothers last autumn. Could Japan yet end up a flag-carrier for liberalisation?

The rise of dark pools

Attack of the clones

Jul 2nd 2009
From The Economist print edition

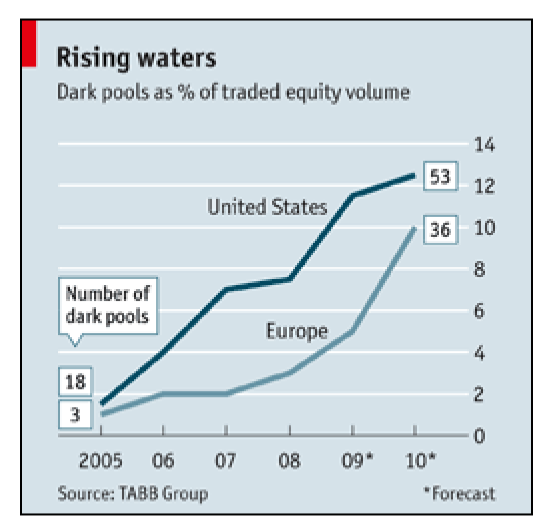
New trading venues offer a challenge to conventional exchanges

THERE is more than a hint of science fiction in the new jargon of finance. Systemic councils are being formed all over the place. America has appointed a "special master" to look at pay practices in bailed-out firms. And in the world of exchanges, "dark pools" are rising fast.

Dark pools are trading venues that match buyers and sellers anonymously. By concealing their identity, as well as the number of shares bought or sold, dark pools help institutional investors avoid price movements as the wider market reacts to their trades.

Most dark pools are operated by electronic exchanges and broker-dealers. As conventional exchanges increasingly handle small, frequently traded orders, dark pools have become the preferred venue for large "block" transactions. In America more than 40 dark pools are in operation, accounting for an estimated 9% of traded equities. The EU's introduction of the Markets in Financial Instruments Directive (MiFID), a framework for financial services that provides for off-exchange trading, is sparking similar growth in Europe (see chart). On June 29th BATS Europe, an upstart electronic exchange with American roots, announced plans to offer dark-pool trading from next month.

The swell of dark pools raises questions for investors, regulators and exchanges. For investors, too many new trading venues may cause liquidity to fragment. Turquoise, a European dark-pool operator owned by a consortium of investment banks, will launch an aggregator on July 20th to scour the dark pools of nine broker-dealers including Citibank, Deutsche Bank and Merrill Lynch in an attempt to offer investors better pricing and a higher rate of matching trades. The market will also do its bit. Although dark pools have captured a significant chunk of equity-trading volumes, many are still struggling to turn a profit. "I have no doubt there will be downward pressure on the total number of dark pools," says Marcus Hooper of Pipeline, another operator, who reckons consolidation will go furthest in Europe.



Regulators voice two contrasting concerns. One is that some dark pools give off signals, or indicators of interest, about positions that others can exploit. Backers say the pools are designed to reduce the ability of investors to front-run large orders. The other is that they hamper price discovery. Mary Schapiro, the chairman of the Securities and Exchange Commission, has expressed concern about their opacity. Immediate disclosure of orders, after they have been executed, is the obvious answer.

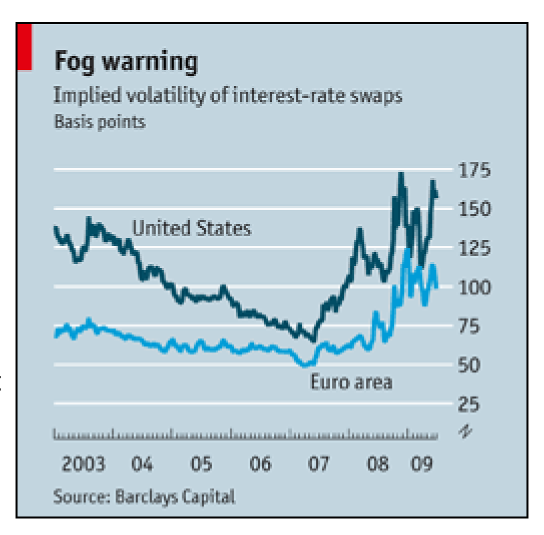
Conventional exchanges are already struggling with lower trading volumes and a meagre flow of public share offerings, both side-effects of the recession. They can ill afford to lose more business to dark pools. Some incumbents are taking the fight directly to the upstarts: the London Stock Exchange, one of the world's oldest bourses, announced on June 29th that it had received regulatory approval for the launch of Baikal, its own pan-European dark pool. Yoda would approve.

Volatility in interest-rate swaps

Rate expectations

Jul 2nd 2009
From The Economist print edition

Long-term inflation worries surge



WHEN markets slide investors become uncertain. They seek to buy insurance against the worst that can happen, and that means buying options. An option is a derivative contract that gives the purchaser the right, but not the obligation, to buy or sell an asset at a certain price. Naturally, those that sell options raise their prices in response to higher demand for insurance. This shows up in the "implied volatility" of the option, which indicates how wild investors expect market swings to be.

In the stockmarket, this measure is known as the Vix (short for volatility index) and is a widely watched indicator of confidence. It soared in the wake of the failure of Lehman Brothers last autumn. But it has slowly subsided and is now down to pre-Lehman levels, a sign that investor confidence is returning.

But as volatility has subsided in equities, it has popped up elsewhere. Interest-rate swaps allow investors and borrowers to switch from a fixed rate to a floating, or variable, rate and vice versa. You can buy an option to take part in a swap, a contract dubbed a "swaption".

The implied volatility of these contracts has shot up in recent months (see chart), indicating that investors are uncertain about long-term interest rates. With good reason: ten-year Treasury bond yields have veered between just over 2% and almost 4% since December. Although many countries are experiencing mild deflation, investors fret. David Woo of Barclays Capital says investors worry about the inflationary impact of fiscal deficits and quantitative easing. "Every European client asks in each meeting about inflation," says Jan Loeys of JPMorgan. They are clearly acting to protect themselves.

House prices and the wealth effect

Home discomforts

Jul 2nd 2009
From The Economist print edition

Brighter data on house prices may not signal a surge in spending

AFTER a long winter, spring brought a touch of sunshine to American house prices. The latest Case-Shiller indices, released on June 30th, showed that prices continued to fall in April: the ten-city index was 0.7% lower than a month earlier, and the 20-city index went down by 0.6%. But these falls were the smallest since June 2008. So even though house prices in America were still roughly 18% lower than a year earlier, many now suspect that the worst is over.

Such optimism may be premature. On June 30th the Office of the Comptroller of the Currency, a bank regulator, said that the number of foreclosures in process rose by 22% in the first quarter of this year, and that the number of prime mortgages with payments at least 60 days late went up by 20%. The government is stepping up its efforts to get people to take part in its anti-foreclosure programmes.

The focus on the housing market is understandable, not least because it has direct links with many other industries. But those who look to housing to lead a broader economic recovery also believe that house prices indirectly affect consumer spending, both by allowing people to borrow against the value of their homes and through something known as the "housing wealth effect".

The theory behind the wealth effect runs as follows. Housing is one of the main assets in which people hold their wealth. Rising house prices make people wealthier, increasing the amount they have to spend over their lifetimes. And they will disburse some of it in the present, because they like to spread their spending roughly evenly over the course of their lives.

This thinking informs economic policy. The Federal Reserve, for example, uses a model of the economy in which housing wealth influences consumer spending to exactly the same degree that financial wealth does. And a number of attempts to measure the effect have found that it not only exists but is large.

Not everyone is persuaded. Willem Buiter of the London School of Economics has argued in the past that when house prices fluctuate, there are both winners and losers, but no net wealth effect. Charles Calomiris, Stanley Longhofer and William Miles are also sceptics. In a new National Bureau of Economic Research paper, the three economists argue that earlier analyses overstate the wealth effect because they do not account for the fact that people who expect to earn more in the future may bid up house prices. They may also spend more, but this extra consumption would not be caused by changes in housing wealth. The authors find an effect of housing wealth on consumer spending that is both much lower than earlier research suggests and a lot smaller than the effect of changes in equity wealth.

But policymakers would still be right to emphasise house prices because their decline has also limited Americans' ability to borrow. The government said on July 1st that Fannie Mae and Freddie Mac, America's housing-finance giants, would now be allowed to refinance mortgages worth up to 125% of a house's value, up from 105%, a limit many have fallen foul of as prices have fallen. Any rise in home prices could still increase consumption, even if it does so by removing credit constraints rather than through the wealth effect.

Bernard Madoff

The Madoff affair

Jul 2nd 2009
From The Economist print edition

Getty Images



Bernard Madoff received a 150-year jail sentence, the maximum possible under American law, on June 29th for overseeing a $65 billion Ponzi scheme. The punishment of Mr Madoff whose fraud was described as "extraordinarily evil" by the judge, still leaves many questions unanswered. Prosecutors continue to investigate whether he was acting in concert with others. Efforts to retrieve money placed with Mr Madoff by duped investors will drag on for years. An internal inquiry by the Securities and Exchange Commission into its failure to spot what he was up to is due to report its findings in a few weeks. Fund managers should not escape scrutiny either. Some clearly winked at Mr Madoff's smooth returns in the belief that he was exploiting inside information.

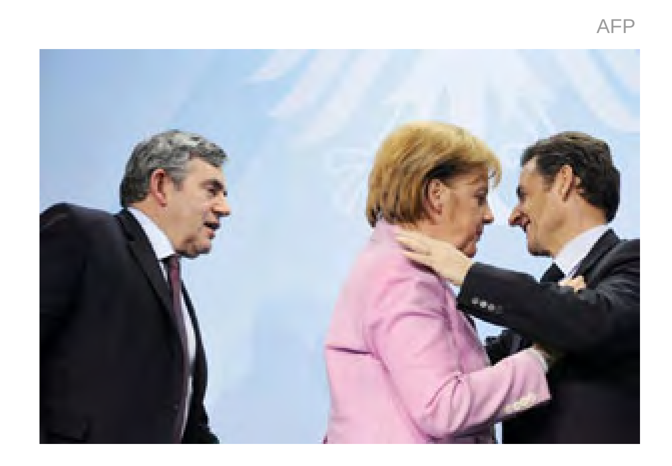
Reforming finance: the EU's proposals

Divided by a common market

Jul 2nd 2009 | BRUSSELS
From The Economist print edition

In the first of an occasional series on the reform of finance, we look at the European Union's proposals

AFP



GIVEN its history of financial meltdown and subsequent recovery, Sweden, which assumed the presidency of the European Union on July 1st, is the ideal country to orchestrate the reform of Europe's financial landscape. Its reputation for levelheadedness will come in handy too. The EU remains riven by two deep divides on the regulation of finance.

The first is an ideological one over the degree of freedom that should be afforded to markets. It pits a weakened and distracted Britain, whose appeal as a financial centre in less troubled times was enhanced by its "light-touch" regulation, against countries such as France and Germany, which feel their long-standing distrust of freewheeling markets has been vindicated. "There is a large body of people who say that the Anglo-Saxon model has failed," says a person involved in the new regulations. "Now they see the chance to bury it." Tougher regulations may also peg London back in its rivalry with other European centres such as Frankfurt or Paris.

The second divide is between countries that want large cross-border banks to be overseen by a single European supervisor and those that want them to stay under the control of home regulators. The question of who is in charge cuts to the heart of Europe's problems. Its banks operate in a largely borderless market but are often closely watched only at home.

The opening shots on supervision were fired on June 18th and 19th when European leaders agreed to establish a European Systemic Risk Board, which is intended to sound the alarm over the build-up of risk, and to create new European supervisory authorities to keep an eye on big cross-border financial institutions. The promise to create new European authorities was hailed by proponents of centralised regulation as a victory over Britain. Nicolas Sarkozy, the French president, called Britain's agreement to their establishment a "complete change in Anglo-Saxon strategy" on financial regulation.

The new structures may not live up to his expectations. The risk board, for instance, has only the power of its voice. In good times its warnings may well be ignored and during a crisis it may have to hold its tongue for fear of sparking panic. Moreover, it seems likely to duplicate work being done globally by the newly christened Financial Stability Board, an international body which held its first meeting on June 26th and 27th.

The new supervisory authorities are also hamstrung. They cannot compel countries to do anything that might cost money ("burden sharing" in the jargon), such as propping up banks with more capital. Nor can they wind up cross-border banks in an orderly way to ensure that all depositors are protected, something that is needed to stop countries from simply grabbing what assets they can when big banks

fail. The danger is that national supervisors in Europe could well end up ignoring the new authorities and erecting barriers to foreign banks instead. “If we stick with national supervision we will end up with national banks,” says Dirk Schoenmaker of the Duisenberg school of finance.

The other major regulatory proposal to have come out of Europe recently inspires even less confidence. The commission has proposed heavy-handed regulation of hedge funds and private-equity firms. The principle of bringing all important institutions into a regulatory net is sound. But the directive clumsily lumps together hedge funds and private-equity firms when imposing disclosure rules and limits on borrowing. The Swedes are well aware of the problems and are likely to ensure that what eventually emerges is acceptable for both industries. Yet the focus on alternative-investment managers, which played a small role in contributing to the financial crisis, suggests that rules are being drawn up to satisfy domestic audiences.

There is another danger. In general the wheels of European policy turn slowly. Proposals on the central clearing of derivatives and bankers’ pay, among others, have been twice delayed in recent weeks and are now expected to emerge later this month. Revisions to rules that will force banks to hold more capital will not be released for months and certainly not agreed before next year. Yet by the time Europe has agreed on a set of common rules, many countries will have already revamped their own.

Britain’s Financial Services Authority, for instance, has already proposed measures to force subsidiaries of big banks operating in Britain to hold more capital. It also wants to use a loophole in European law that gives it the power to impose liquidity requirements on the local branches of banks from elsewhere in Europe. These are moves that appear to undermine the principle of Europe’s single market in banking.

Centrifugal forces

National governments have bailed out their banks in exchange for an explicit or unspoken promise to keep up lending to small businesses in their home markets (although some have supported continued lending in troubled eastern European and Baltic countries). The European Commission’s competition watchdog, which is policing the aid, also appears to be contributing to fragmentation, albeit unwittingly. Axel Weber, the president of the Bundesbank, Germany’s central bank, recently complained that it was forcing banks to focus their lending and borrowing in their home markets, a charge the commission has hotly denied. Those most keen to reform European finance may yet find their principal sin is tardiness. For even as they write new rules, the market they want to regulate is fragmenting before their eyes.



Economics focus

Put out

Jul 2nd 2009
From The Economist print edition

Uncertainty over the size of the output gap complicates the task of central banks

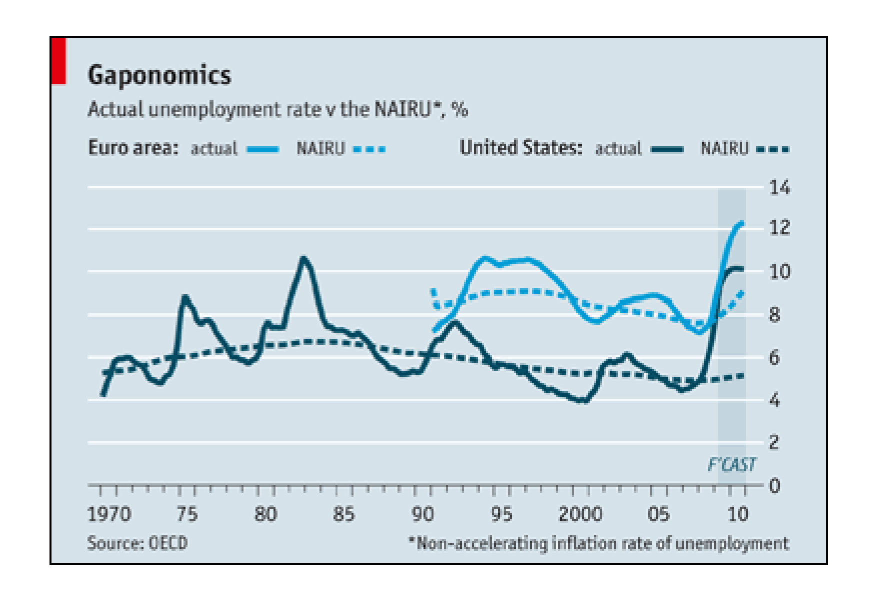
HAVING raised the alarm on deflation, the Federal Reserve has now begun to sound the all clear. The statement it released after its policy meeting on June 24th notably omitted the warning from its three prior meetings that "inflation could persist for a time below rates that best foster economic growth and price stability". To be sure, with the economy gradually finding a bottom and the rate of decline in home prices slowing, the chances of a downward spiral of deflation and economic activity have diminished. Yet it seems premature to write off the threat as long as a large output gap persists. The output gap is the difference between actual economic output and the most the economy could produce given the capital, know-how and people available. When actual output exceeds potential, demand for products and labour bids up prices and wages, fuelling inflation. When actual output falls short, competition for scarce sales and jobs puts downward pressure on inflation.

Estimating how big the output gap is, and how much of a deflationary threat it still poses, is not easy. The Congressional Budget Office (CBO) estimates that the gap topped 6% in the first quarter of this year and will average more than 7% in 2009, which would be the largest figure on record. Given that core inflation was so low when the recession began, it is not a stretch to believe that, with so much slack in the economy, it could yet turn negative. But this view has been challenged in a note by John Williams and Justin Weidner of the Federal Reserve Bank of San Francisco. Rather than follow the conventional route of deriving an inflation forecast from an estimate of potential output, they do the opposite: they infer the output gap from the behaviour of inflation. As in the euro zone, where consumer prices fell for the first time ever in the 12 months to June, and Japan, where inflation excluding perishable food was -1.1% in May, inflation in America is now negative because of a drop in fuel prices last year. But core inflation is 1.8%, within its range this decade. The authors take this as evidence that the output gap may have been only 2% in the first quarter, implying little or no threat of deflation.

NAIRU's non-alignment

This divergence in estimates highlights the biggest problem in relying on the output gap: it is a slippery thing to measure. How do you really gauge a firm's capacity, especially in services? How many of those not working could work? How fast is productivity growing over time? Economic shocks make the task even harder. They may render big chunks of the capital stock obsolete: many idle car factories, for example, may never reopen. Workers thrown out of a shrunken industry like finance or construction may take years to retrain for another. Some may never succeed. Although unemployed, they are not really competing for the jobs that fall vacant and are thus not putting much downward pressure on wages. That means the "non-accelerating inflation rate of unemployment", or the Nairu, may have risen. In other words, when actual output falls, it can drag potential output down with it—the main reason why Mr Williams and Mr Weidner believe that the gap is smaller than the CBO's estimates.

That recessions can reduce potential output is not controversial. The question is: by how much? In its latest *Economic Outlook*, the OECD concludes that the collapse in business investment will cause potential output to grow more slowly in America this year and next but that it will not fall. It does think the Nairu will rise measurably in the euro area, where relatively rigid labour markets mean someone who loses a job will take much longer to find another, during which time his skills atrophy. But in the United States, whose job market is more flexible, the Nairu will barely rise (see chart).



If Mr Williams and Mr Weidner are wrong and the output gap is large, then there are other explanations for why American inflation has not fallen further. The simplest is that not enough time has elapsed. Chris Varvares of Macroeconomic Advisers, a forecasting consultancy, thinks that core inflation will fall to close to zero in 2011. While it has been firm so far this year, he argues it will fall noticeably later this year as residual seasonal factors recede.

Even if inflation were to fall to between zero and 1.5%, say, that would be a small drop given the CBO's estimate of the output gap. A comparable gap in 1981-83 produced a drop in core inflation of six percentage points. But in the early 1980s, inflation had fluctuated so much for so long that workers and firms quickly adapted their wage- and price-setting behaviour to the latest trends, so inflation responded more swiftly to falling demand. Since then, inflationary expectations have stabilised at around 2%, which means that inflation responds more sluggishly to demand (as the recessions of 1990-91 and 2001 demonstrated). The OECD notes that when Finland and Canada experienced large and persistent output gaps in the 1990s, inflation fell quite far but did not become deflation, which it attributes in part to the success of central banks in anchoring expectations with inflation targets.

Such expectations may rise if investors worry that central banks will print money to finance governments' rising fiscal deficits. But even if they remain well anchored, expectations alone do not explain why inflation does not respond more to economic slack. A large and persistent output gap in the 1990s eventually tipped Japan into deflation in 2000; inflation expectations also turned negative. As long as the gap persisted, deflation should have accelerated. It did not, ranging from -0.3% to -0.9% between 2000 and 2003. According to Ken Kuttner, an economist at Williams College, Japan's output gap may have been smaller than thought; workers may have resisted pay cuts; and perhaps most important, at low rates of either inflation or deflation firms may change prices less frequently, reducing the impact of output gaps.

If so, this would provide a buffer to deflation in the rich world today, despite the presence of large gaps. But the thought is not entirely comforting. It also means that if inflation does fall to zero or turns slightly negative, it could be difficult to get it back up. The best cure for deflation remains prevention.

Award: Bill Emmott

Jul 2nd 2009
From The Economist print edition

Bill Emmott, our editor from 1993 to 2006, received a lifetime achievement award at the 2009 Loeb Awards for business and financial journalism in New York on June 29th.

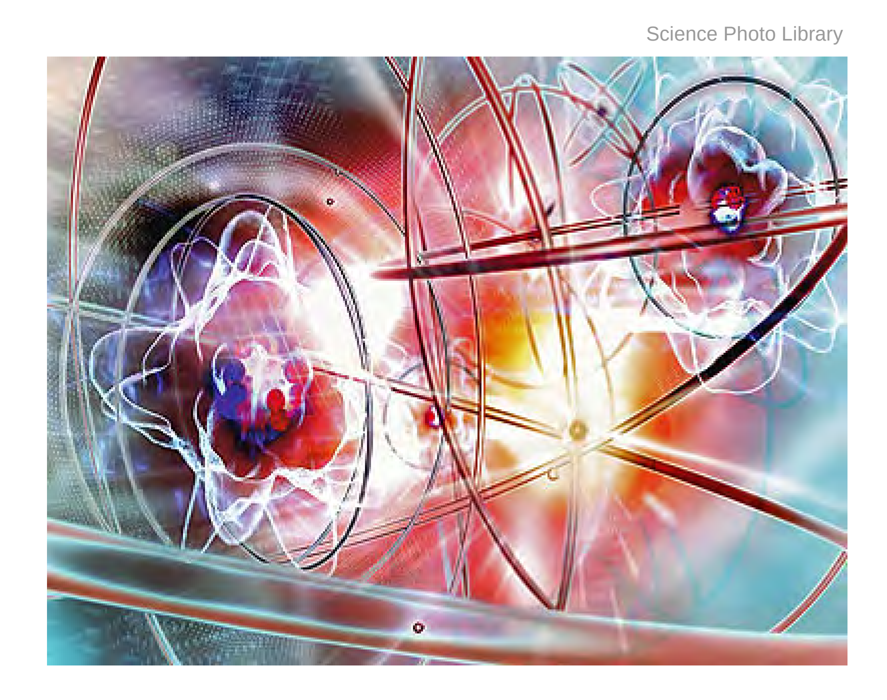
New materials for renewable energy

The power of being made very small

Jul 2nd 2009
From The Economist print edition

Nano-engineering can produce substances with unique properties that will give renewable energy a boost

Science Photo Library



BIG improvements in the production of energy, especially from renewable sources, are expected over the coming years. Safer nuclear-power stations, highly efficient solar cells and the ability to extract more energy from the wind and the sea are among the things promised. But important breakthroughs will be needed for these advances to happen, mostly because they require extraordinary new materials.

The way researchers will construct these materials is now becoming clear. They will engineer them at the nanoscale, where things are measured in billionths of a metre. At such a small size materials can have unique properties. And sometimes these properties can be used to provide desirable features, especially when substances are formed into a composite structure that combines a number of abilities. A series of recent developments shows how great that potential might be.

Grand designs

Researchers have already become much better at understanding how the structure of new nano-engineered materials will behave, although the process remains largely one of trial and error because different samples have to be repeatedly manufactured and tested. Michael Demkowicz of the Massachusetts Institute of Technology is developing a model that he hopes will address the problem from a different direction: specifying a set of desired properties and then trying to predict the nanostructures needed to deliver them.

Dr Demkowicz is working with a team based at the Los Alamos National Laboratory, one of a number of groups being funded under a new $777m five-year programme by the American government to accelerate research into energy technologies. The material Dr Demkowicz is looking for will be good at resisting damage from radiation. It could be used instead of stainless steel to line a nuclear reactor, which would extend the reactor’s working life and allow it to be operated more efficiently by burning a higher percentage of nuclear fuel. At present, says Dr Demkowicz, reactors burn only around 1% of their fuel, so even a modest increase in fuel burn would leave less radioactive waste.

The reason why the linings of nuclear reactors degrade is that metals can become brittle and weak when they are exposed to radiation. This weakness is caused by defects forming in their crystal-lattice structure, which in turn are caused by high-energy particles such as neutrons bumping into individual atoms and knocking them out of place. When these displaced atoms collide with other atoms, the damage spreads. The result is holes, or "vacancies", and "interstitials", where additional atoms have squeezed into the structure.

Dr Demkowicz says it is possible to design nanocomposites with a structure that resists radiation damage. This is because they can be made to exhibit a sort of healing effect in the areas between their different layers. The thinner these layers are, the more important these interfaces become because they make up more of the total volume of the material. Depending on how the nanocomposites are constructed, both the vacancies and the interstitials get trapped at the interfaces. This means there is a greater chance of their meeting one another, allowing an extra atom to fill a hole and restore the crystal structure. In some conditions the effect can appear to show no radiation damage at all, he adds.

The ideal nanocomposite would not only resist radiation damage. It would also not itself become radioactive by absorbing neutrons. Dr Demkowicz has used his modelling techniques to come up with some candidates; iron-based ones for fission reactors and tungsten-based ones for those that may one day use nuclear fusion. It could still take years before such materials are approved for use, but the modelling methods will greatly speed up the process.

Across the spectrum

Nano-engineered materials will also play an important role in a more efficient generation of solar cells, according to an exhibition by researchers at Imperial College, London, called "A Quantum of Sol", which opened this week at the Royal Society Summer Science Exhibition, also in London. Again, the desired effects are obtained by using combinations of material produced at extremely small sizes. In this case, they are used to make "multi-junction" solar cells, in which each layer captures energy from a particular colour in the spectrum of sunlight. Overall, this is more efficient than a conventional solar cell which converts energy from only part of the spectrum.

Whereas conventional solar cells might turn 20% or so of the energy in sunlight into electricity, multi-junction solar cells already have an efficiency of just over 40% and within a decade that could reach 50%, predicts Ned Ekins-Daukes, a researcher at Imperial. Until nano-engineering costs come down with economies of scale, multi-junction solar cells will remain expensive. The researchers expect that electricity-generation costs can still be cut in the meantime by using mirrors to concentrate sunlight on the cells.

Through the glass

Solar cells could also be incorporated into the structure of buildings, including windows. Researchers at the Fraunhofer Institute for Mechanics of Materials are looking for suitable transparent materials to make them. They too are using computer models to explore atomic structures and then to simulate how electrons will behave in them. With the right combination of conductive and transparent material, says Wolfgang Körner, from the German institute, it should be possible to produce completely see-through electronics.

The nanostructure of composites can also provide great mechanical strength in relatively light materials. Composites such as fibreglass and carbon fibre bonded in a plastic resin are already widely used to replace metal in making, for instance, cars and aircraft. But by controlling the direction and the tension of the fibres during their construction it is possible to produce a morphing composite, which adjusts its shape under certain conditions. The change can be instigated by an external control or it can be automatic, for instance in response to variations in heat, pressure or velocity.

These morphing composites could be used to produce more efficient turbine blades in wind and tidal generators, a seminar at Bristol University's Advanced Composites Centre for Innovation and Science was told this week. A bistable composite capable of altering its aerodynamic profile rapidly when wind and current conditions changed would help to remove unwanted stresses in the blades. That would increase the efficiency of the blades and extend the working life of the generator systems they power, says Stephen Hallett, a member of the Bristol team. Morphing composites would mean, for instance, that tidal generators could be made smaller and would last longer, which would make them more viable

commercially. In this way many tiny changes in the science of materials could generate a big future for renewable energy.

A new way to keep hydrogen

Plumage power

Jul 2nd 2009
From The Economist print edition

Chicken feathers could provide a high-capacity store

Alamy



Forget about putting a tiger in your tank

HYDROGEN has long been touted as the future of energy. It is clean, efficient and the most abundant substance in the universe. It can be used to run an internal combustion engine in a car or power one using a fuel cell, with heat and water as the only emissions. But hydrogen is difficult to store because it is the lightest element. Filling a typical fuel tank of 75 litres—about 20 American gallons—with hydrogen at room temperature and pressure will take a hydrogen-powered car only about a kilometre or so. The gas can be compressed to take up less space, but that can be dangerous. It also uses energy, which removes some of the benefits.

Another way to store hydrogen is to put something inside the tank which increases the total internal surface area to which the molecules of the gas can cling. This means more hydrogen can then be packed into a smaller volume. There has been some progress with materials that can do this, including specially engineered carbon nanotubes. But carbon nanotubes are very expensive to make, especially in large quantities. Richard Wool, a chemical engineer at the University of Delaware, estimates the cost of fitting a single car with a tank full of carbon nanotubes to be $5.5m. Other materials might do, but they could still end up costing over $20,000 a car.

Dr Wool and a colleague, Erman Senöz, think they have found a way to bring the price down to only around $200 a car by using chicken feathers. The fibres in feathers are almost entirely composed of keratin, a protein also found in hair and nails. When heated in the absence of oxygen (a process called pyrolysis), keratin forms hollow tubular structures six millionths of a metre across and riddled with microscopic pores, much like carbon nanotubes.

The researchers demonstrated how this can be done at the 13th Annual Green Chemistry and Engineering Conference, held recently in College Park, Maryland. To avoid melting the fibres and depriving them of their desirable structural properties, they first heat-treated the feathers to around 215°C. This strengthened their structure and allowed further heating to 400-450°C. At this point the material becomes more porous, increasing its surface area and its hydrogen-storing capacity.

The substance they created is capable of holding 1.5% of its weight in hydrogen. Since about 4.5kg of the gas is needed to cover 480km (about 300 miles), the typical range of a petrol-powered car, this would translate into a rather large 284-litre tank stuffed with some 300kg of carbonised chicken feathers, according to Mr Senöz. This still falls short of the 6% hydrogen-storage target which has been set by America’s Department of Energy to encourage innovation with alternative fuels. But the researchers think they can improve their material further by making it even more porous. And unlike rival technologies

theirs is well on the way to meeting the department's cost criteria of a hydrogen system that costs $4 per kilowatt hour stored and less than $700 for installing it. Moreover, it could also help with another environmental problem: reducing the mountains of chicken feathers that the poultry industry has to dispose of every year.

Babies' names and the internet

Local yokels

Jul 1st 2009
From The Economist print edition

Electronic communications may have shrunk, rather than expanded, horizons

Jupiter



THE rise of the internet was supposed to create a global village, in which people would be as likely to have friends in the antipodes as in their own street. Poppycock, of course. But the idea that it might instead have shrunk people's horizons is truly counter-intuitive. Yet that is what Jacob Goldenberg and Moshe Levy of the Hebrew University in Jerusalem suspect. Their evidence is indirect, and from a strange source—the spread of babies' names. But it does suggest that something worthy of investigation is going on.

The two researchers' study of the spread of new names was prompted by their discovery that the relationship between the number of private e-mails sent in America and the distance between sender and recipient falls off far more steeply than they expected. People are overwhelmingly e-mailing others in the same city, rather than those far away.

That says something about human relations, but not how they have changed since e-mail became ubiquitous. So Dr Goldenberg and Dr Levy needed to find something pertinent that bridged the period in question and might thus shed more light on their result. In an inspired piece of lateral thinking, they decided to look at how babies' names spread.

State of names

America's Social Security Service keeps a register that contains the 100 most popular names in each state every year and the number of babies given them. Dr Goldenberg and Dr Levy speculated that when parents chose a name for a child, they were influenced by their interactions with other new parents, so the spread of the names the babies were given was a proxy for the pattern of those interactions.

The researchers took data from 1970 to 2005 and traced the propagation of names in and between states over that period. They did this by calculating what they called a "proximity-effect index" for each of the 100 most popular names in each state. For each name, they divided the country into two groups: one consisting of states in which the name was already popular and their immediate neighbours; and one consisting of states in which the name was relatively unknown.

They then counted how many babies had been born in each state, and the proportion given a certain name. For example, if an eighth of babies born in America were delivered in California then, all other things being equal—in particular, if geography made no difference—you might expect an eighth of all babies with any given name to be Californian.

What Dr Goldenberg and Dr Levy found was that the proportion of babies given a certain name in a state where that name was already popular or in a neighbouring state was 20% higher than would otherwise have been expected. This was true from the 1970s to the early 1990s.

From 1995 to 2005, however, the effect became even more pronounced. The proportion of newborns with common names in any given state and its immediate neighbours became 30% higher than would have been expected if there were no geographic effect. Dr Goldenberg and Dr Levy ascribe this rise to the internet. It certainly correlates with the emergence of the web, though whether the correlation reflects causation is unproven. But whatever the reason, it is a curious result.

Evolution and climate change

Survival of the less fit

Jul 3rd 2009
From The Economist print edition

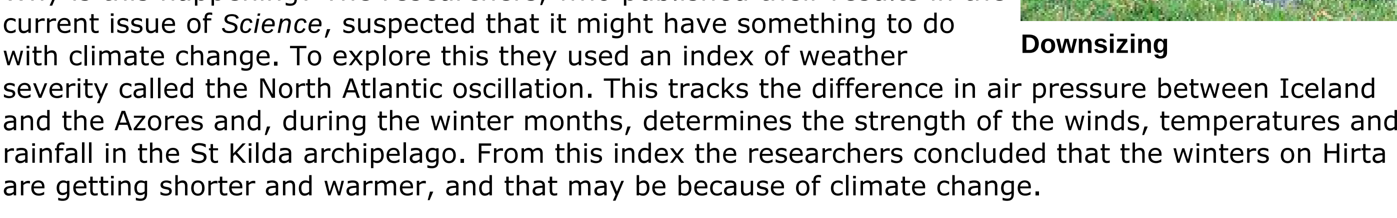
The mystery of Scotland's shrinking sheep may have been solved

Alamy

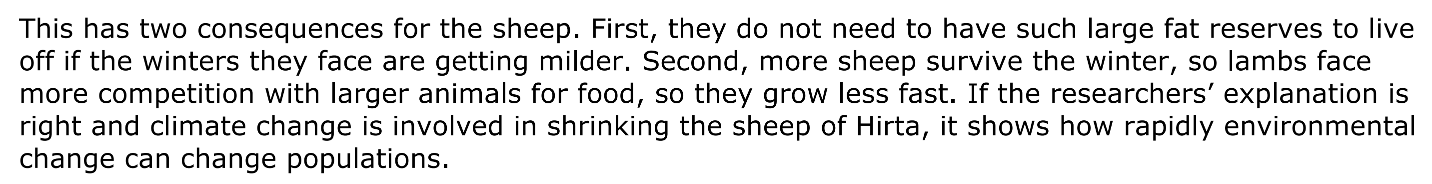
Downsizing

ON THE remote island of Hirta, in the St Kilda archipelago beyond the Outer Hebrides, live hundreds of wild Soay sheep. Over the past 20 years biologists studying this primitive breed, which has not changed much since the Bronze Age, have noticed that the sheep are getting smaller. This was a puzzle because, in general, bigger animals are usually much better at surviving the island's extremely cold winters. The biologists now think that climate change could be involved.

Tim Coulson of Imperial College, London, and his colleagues examined the weights of about 2,000 female sheep that lived on the island in the two decades of their study. They combined this information with detailed histories of individual animals. They found that daughters were, on average, lighter than their mothers had been at the same age. Their legs were shorter, too, suggesting that the breed really was shrinking.



Why is this happening? The researchers, who published their results in the current issue of *Science*, suspected that it might have something to do with climate change. To explore this they used an index of weather severity called the North Atlantic oscillation. This tracks the difference in air pressure between Iceland and the Azores and, during the winter months, determines the strength of the winds, temperatures and rainfall in the St Kilda archipelago. From this index the researchers concluded that the winters on Hirta are getting shorter and warmer, and that may be because of climate change.



This has two consequences for the sheep. First, they do not need to have such large fat reserves to live off if the winters they face are getting milder. Second, more sheep survive the winter, so lambs face more competition with larger animals for food, so they grow less fast. If the researchers' explanation is right and climate change is involved in shrinking the sheep of Hirta, it shows how rapidly environmental change can change populations.

Communism

Dead end

Jul 2nd 2009
From The Economist print edition

Mankind's biggest mistake

Corbis



The Rise and Fall of Communism. By Archie Brown. *Ecco; 736 pages; $35.99. The Bodley Head; £25*. Buy from Amazon.com, Amazon.co.uk

WHY did communism take root? Given its sorrowful harvest, why did it keep spreading? And what ever enabled it to last so long? Archie Brown's new history of communism identifies three big questions, perhaps even the biggest, of the past century.

At first sight, all seem puzzling. Communism was an impractical mishmash of ideas, imposed by squabbling zealots that promised much, delivered little and cost millions of lives. It is striking that 36 countries at one time or another adopted this system and that five—Cuba, Laos, North Korea, Vietnam and the biggest of them all, China—still pay lip service to it.

Communism's first big advantage was that it played on two human appetites—the noble desire for justice and the baser hunger for vengeance. Mr Brown, emeritus professor of politics at Oxford University, traces communism's idealistic roots in the struggle against feudal oppression and beastly working conditions. The moral weight of Karl Marx's criticisms of 19th-century capitalism even won him praise from the high priest of Western liberalism, Karl Popper, a Viennese-born philosopher who emigrated to London. But the intoxicating excitement of revolutionary shortcuts attracted the ruthless and dogmatic, who saw the chance to put into practice Marx's muddled Utopian notions—and settle some scores on the way. "The more representatives of the reactionary clergy and reactionary bourgeoisie we succeed in killing, the better," wrote Lenin in 1922. Even so, many still resist the idea that the founding fathers of communism were murderous maniacs. Revolutions against corrupt and ossified regimes in countries such as Russia and China stoked a steamy enthusiasm that took decades to dissipate.

The communist block also had two bits of good fortune. The economic slump of the 1930s discredited democracy and capitalism. Then came Hitler's disastrous attack on the Soviet Union. The victory over fascism in Europe gave the Soviet Union, an ally of America and Britain, renewed moral weight. Given

what had happened in Russia under Stalin in the 1930s, that hardly seemed deserved. As Mr Brown notes, Stalin trusted the Nazi leader more than he trusted his own generals. The Soviet Union killed more top German communists than Hitler's regime did. Yet in some countries, Czechoslovakia for example, Soviet forces were initially welcomed as liberators, and Stalinist regimes took power with a degree of popular consent. In other countries, such as Poland and the Baltic states, it looked different: one occupation gave way to another.

The promised communist nirvana brought a mixture of mass murder, lies and latterly the grey reality of self-interested rule by authoritarian bureaucrats. But it was a bit late for second thoughts. Communist regimes proved remarkably durable, partly thanks to the use of privileges for the docile and intimidation of the independent-minded. Another source of strength was tight control of language and information that deemed most criticism unpatriotic. Cracks came as information spread, especially about the system's bogus history and economic failings. Nationalism was a potent solvent too, particularly in places such as the Baltic states, that felt they were captive nations of a foreign empire.

Mr Brown deals conscientiously with communism in Asia and the solitary Latin American outpost of Cuba. But his main expertise, acquired over decades of scholarly study, is in the Soviet Union and its east European empire. His account is studded with delightfully pertinent and pithy personal observations and anecdotes: the censors in tsarist Russia decided that Karl Marx's "Das Kapital" was so boring that it wasn't worth banning. Lenin thought 1917 was too early for revolution in Russia. At the Battle of Stalingrad, 50,000 Soviet citizens, including turncoats, volunteers and conscripts, were fighting on the German side. An American communist agitator once began a speech with the immortal lines: "Workers and peasants of Brooklyn". Nikita Khrushchev hated putting things in writing because he couldn't spell.

It is easy to be polemical about communism. Mr Brown strives to be fair-minded. He gives careful weight to the achievements of the Soviet regime, particularly in bringing mass literacy to Russia, and unparalleled social mobility. But he is sometimes too lenient. Was the Soviet Union under Leonid Brezhnev really just an authoritarian regime, rather than a totalitarian one? Saying that the Soviet Union "repossessed" the Baltic states in the secret Hitler-Stalin pact in 1939 would strike most people there as a glaring misreading of history. And his discussion of economics is skimpy and clichéd.

Yet as a single-volume account of mankind's biggest mistake, Mr Brown's book is hard to beat. Readers over the age of 40 will find it an uncomfortable reminder of a dangerous and dismal past. For most younger readers, it will seem all but unimaginable.

Russia's intelligentsia under communism

Yearning to be free

Jul 2nd 2009
From The Economist print edition

Illustration by Daniel Pudles

Zhivago's Children: The Last Russian Intelligentsia. By Vladislav Zubok. *Harvard University Press/Belknap; 464 pages; $35 and £25.95*. Buy from Amazon.com, Amazon.co.uk

THE Soviet Union was a prison, especially for the lively minded, whose travel abroad and activities at home were dictated by the Communist Party's cultural commissars. But in the period between the end of the Stalin terror and the start of the Brezhnev era's grim stagnation, a lucky few enjoyed some wisps of freedom.

Cultural continuity between that period and a lost past is the central theme of "Zhivago's Children". The metaphorical reference is to Tanya, the child of Yuri and Lara Zhivago in Boris Pasternak's great novel. Brought up by peasants, "she has no opportunity to inherit the tradition of free-thinking, spirituality and creativity that her father embodied." How will she turn out? The novel leaves that fictional question unanswered. Vladislav Zubok's book shows, with great sympathy and insight, what happened to Tanya's real-life counterparts.

The Zhivago legacy is Russia's "silver age", when Anna Akhmatova, a poet, and Vasily Kandinsky, a painter, as well as others, flowered towards the end of the tsarist era and in the emancipated years immediately after the Bolshevik revolution. But Stalin, who liked uplifting stories and pictures featuring combine harvesters, banned their work as subversive and decadent. Many perished in the murderous frenzy of the 1930s. Yet enough survived to preserve at least some of the knowledge and traditions of the past.

The huge expansion of Soviet higher education after the war was supposed to create docile "cultural cadres". What emerged were young people, marked by "boundless, sparkling optimism", proud of their country's achievements but open-minded to its failings. After Stalin's death, their independent thought and behaviour became "oxygenated". Tight-knit circles of friends, *kompany* in Russian, discussed love, life, letters and more. In one such group the young Mikhail Gorbachev struck up an instant, passionate and lifelong liaison with a bright culture-vulture called Raisa.

Writers such as Pasternak and Akhmatova were privately revered in these circles. But the real thaw began under the leadership of Nikita Khrushchev. The World Youth Festival in Moscow in 1957 produced an orgy, sometimes literally, of contacts with thousands of visiting foreigners including from the capitalist West. In a society where such meetings had been as unlikely as a total solar eclipse, that had a huge impact. So did a freer press: the hard-hitting mass-market newspaper, *Izvestia*, and brainy, liberal-minded periodicals such as *Novy Mir*. As cultural iconoclasm swelled, Stalinist clichés (and the hacks who produced them) began to tumble.

Other controversies raged too, such as "lyrics v physics". One camp believed that science would perfect society. The other sought answers from art and literature. Disagreement over that ended friendships and marriages. As the mental wounds of terror and war began to heal, the hardy survivors of the 1930s began to speak more freely to their young counterparts. Growing knowledge of the lies and crimes of the past barely shook the new intelligentsia's faith in the Soviet system. Their world view was still Marxist, their patriotism genuine. Yet in their self-awareness and sense of mission, Zhivago's children began to resemble the Russian intelligentsia of a century before.

Mr Zubok poignantly details the lengthy and bitter decline that followed. The earthy Khrushchev resented

the cultural elite's pretensions. Party bureaucrats saw them as subversive. The crushing of the Prague Spring destroyed faith in the Soviet system, and the intelligentsia splintered. A growing camp favoured Russian traditions and even chauvinism, denouncing the others as disloyal and cosmopolitan (and Jewish). Some writers collaborated out of cowardice or cynicism; others emigrated. A lonely few became dissidents, focusing intensely on support from the West, largely detached from everyday life in their own country. Similar divisions remain in Russia now.

The picture Mr Zubok paints so painstakingly is vivid. Yet it is only a tiny corner of the dreary canvas of Soviet life. A few thousand people in Moscow and St Petersburg had a nice and interesting time in the 1950s. But for many millions of their fellow-inmates, the Soviet decades were unrelievedly awful.

Barack Obama's presidential campaign

Man of the moment

Jul 2nd 2009
From The Economist print edition

Renegade: The Making of a President. By Richard Wolffe. Crown; 368 pages; $26. *To be published in Britain by Virgin Books in August.* Buy from Amazon.com

THE great occupational hazard for any biographer is falling too much under the sway of his or her subject, becoming at best a biased observer, and at worst a propagandist. When the subject is alive, the hazard is greater. When the subject is the intelligent, charming and history-making Barack Obama, the hazard is obviously greater still. Unfortunately, Richard Wolffe has fallen right into the trap.

That is a pity, for there is much in "Renegade" to enjoy. It is a fly's-eye view of one of the most thrilling political insurgencies in modern American history, involving the construction of a wholly new style of campaigning based around the internet and the recruitment of an army of small-dollar donors and young volunteers. Mr Wolffe, formerly a reporter for *Newsweek*, but now a television commentator, flew on the candidate's plane, rode on his campaign buses and in his motorcades and saw the whole show, from its inception in wintry Illinois to the inauguration on an even colder Washington morning. He seems to have had abundant access, not just to Mr Obama but also to most of his senior staff. He has put together a readable and intermittently thoughtful account of what happened. The best bit is a long central section about the impact of race on the election.

Such an "authorised" project is, by its nature, inherently one-sided. At no point does Mr Wolffe attempt to give his readers any sense of the campaign as seen from the viewpoint of the Clinton camp or the McCain team: for that the reader must wait for better books by less embedded people. But what is more surprising is that this exceptional access has produced so little that is new. Perhaps there are simply no secrets to be found, though that seems unlikely. When Mr Wolffe does unearth a nugget, it can be quite good: the description of the utter calm with which Mr Obama faced his unexpected defeat in New Hampshire rings true and is genuinely arresting. And young Malia Obama's observation to her father: "First African-American president: better be good," is, if true, priceless.

But there is too little gold and too much drivel. A great deal of the exclusive briefing seems to consist of insiders expatiating on the stupendous qualities of their candidate. Peter Rouse, in particular, really ought to consider legal action against Mr Wolffe for making him seem sycophantic far beyond the call of spin.

Early British tourists

The rosbifs arrive

Jul 2nd 2009
From The Economist print edition

The Smell of the Continent: The British Discover Europe. By Richard Mullen and James Munson. *Macmillan; 368 pages; £20*. Buy from Amazon.co.uk

"TRAVELLING is a very troublesome business," advised Charles Dickens's *Household Words* magazine in 1852. According to the accounts drawn from letters, diaries and public sources in this compendium of facts, figures and travellers' tales from the 19th century, he was right. What with the lack of cutlery, clean sheets, hot water for tea and baths, the constant threat of arrest, assault or robbery, the menacing presence of mustachioed foreigners and the state of the lavatories, it is surprising that the British ever embarked on foreign travel at all.

However, they did, and on a scale that astonished their hosts. In the 100 years between the fall of Napoleon and the outbreak of the first world war travel became one of the great boom industries of the age. Using records carefully amassed by the French police and port authorities, Richard Mullen and James Munson estimate that fewer than 10,000 people travelled from Britain to the continent in 1814. By the 1860s the figure had grown to a quarter of a million each year. In 1911 the *Times* reported that 1m Britons were visiting the continent annually.

Mass travel was an expression of the industrial wealth and imperial confidence of the 19th-century British. Advances in technology made it possible. At the beginning of the century the journey from London to Paris took three or four gruelling days and nights; by mid-century mechanisation had reduced this to less than 11 hours, making a day out to the French capital feasible. In place of the months-long tours of the Rhineland and Switzerland undertaken by early 19th-century travellers, tourism became all about speed and brevity. Well before 1914 a Londoner could leave home in the early morning, lunch in Paris, cram in some shopping, and still be home in time for dinner. This day-tripping was rather different to the logistical challenges faced by earlier travellers, even if those were self-inflicted. When one Colonel Thornton embarked for France in 1814 he and his six guests took three carriages and coachmen, a variety of servants, including chief butler and falconer, three hawks, ten horses, 30 guns and as many as 120 hounds.

Remarkable as the spectacle of Colonel Thornton's party must have been, he was hardly alone in his extravagant oddity. The English tourist of the early part of the century frequently went to considerable pains and expense to ship to the continent horses and coaches, the latter often luxuriously appointed. Lord Byron's, for example, incorporated beds, dining facilities and a library. Such carriages were designed not only to free the traveller from the discomfort of public transport but also to display wealth, status, technological superiority and, as John Ruskin put it, to achieve "the abashing of plebeian beholders". Travel was not just about seeing, but about being seen.

The accounts of travellers everywhere tend to reveal as much about the visitors as about the places they visit. Despite the increase in the speed and decrease in the cost of travel during the 19th century certain patterns remain constant: the tourist of 1814 expended much energy on complaining about other tourists; many travellers remarked that continental hotels offered a service that was twice as good at half the price of the British equivalent; continental railways were better run than those at home. You could hear the same today. The greatest difference was in attitudes to food. The Victorian Briton regarded empire-building English food as superb and that of France or Italy as dangerous, disgusting or both. Today that situation has largely reversed.

This book is a jolly, jam-packed, rapid-fire tour of its subject. Just what holiday reading should be all about.

Raising goats

Nanny diaries

Jul 2nd 2009
From The Economist print edition

Goat Song: A Seasonal Life, A Short History of Herding and the Art of Making Cheese. By Brad Kessler. *Scribner; 256 pages; $24*. Buy from Amazon.com

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Say cheese

"EVERY raw-milk cheese is an artefact of the land. It carries the imprint of the earth from which it came. It's a living piece of geography. A sense of place." So says Brad Kessler in this meditation on the origins of pastoralism and the joy of making a living from livestock.

After tiring of Manhattan, Mr Kessler, a novelist, moves with his photographer wife to a 75-acre (30-hectare) goat farm in Vermont. As they throw off the shackles of the city the couple learn how to rear, breed and milk their goats and how to make cheese: salty, piquant *mozzarella*, floral *chèvre* and, ultimately, an aged, hard *tomme*, its inside the colour of old piano keys, its taste redolent of a freshly scythed meadow. As he hones his skills as goat farmer and cheesemaker—the grittiness of the former and the serenity of the latter providing a measured contrast—Mr Kessler explores how pastoralism underpins many aspects of human culture and how alphabets, art, diet and economy often grew out of a pastoralist setting. The letter "A" comes from the Hebrew *aleph*, meaning ox. Turn an "A" upside down and you have the head of an ox, its horns pointing up to the heavens. Paintings from the Paleolithic era, mankind's earliest art, portray herbivorous animals. The word pecuniary, relating to money, comes from *pecus*, the word for cattle in ancient Rome.

Mr Kessler's new life and learning would not have been possible without his goats; leggy, long-eared, characterful Nubians which caper (root, *capra*, the Latin for goat) throughout the pages of this book. The author provides a fascinating account of their needs and antics: their days of foraging, ruminating, sleeping and playing; the messy urine and semen soaked ritual of mating; the magical birth of twin kids who instinctively search for their mother's milk only to be removed from her immediately to be bottle fed. The milk is for cheesemaking and this human trickery gave English the word kidnapping. Making a living from animals is certainly rewarding but no one ever said it was kind.

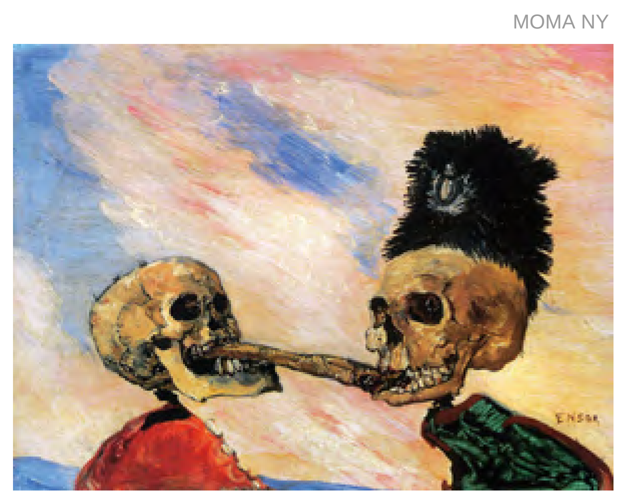
James Ensor at the Museum of Modern Art

Masked ball

Jul 2nd 2009 | NEW YORK
From The Economist print edition

A Belgian master finally gets the recognition he deserves

MOMA NY



Parable of the pickled herring

JAMES ENSOR seems to have slipped between the cracks. An innovative Belgian artist who was influential in shaping expressionism and surrealism, he is often overlooked. This is especially true in America, where his work is thinly scattered across a number of museums and largely ignored.

Ensor's renown may be about to change. The artist's first big American show for 30 years, at the Museum of Modern Art (MoMA), is intended to reassert his place in the canon. But just where he belongs remains a mystery. The works on view, which range from cartoonish drawings of religious scenes to bright little paintings of fighting skeletons, reveal that, if nothing else, Ensor was certainly something of an oddball. "He is very slippery," explains Anna Swinbourne, who organised the exhibition and edited the catalogue. "Was he a forbear of expressive use of colour? Of modern caricature? The more you research, the less you know."

Born in 1860 in the Belgian seaside resort town of Ostend, Ensor (whose fame as an artist at home is surpassed only by that of René Magritte and Hergé, the creator of Tintin) painted his coastal surroundings with a sure, naturalistic hand. By the age of 17 he was off to Brussels to study at the prestigious Académie Royale des Beaux-Arts. But after three years he returned to Ostend, irked by academic officialdom and rich with avant-garde connections. Ensor made his artist's studio in the attic of his family's home, where his mother ran a souvenir shop selling beach trinkets and masks for the annual carnival. He never married and rarely left Ostend again.

The MoMA show is arranged chronologically, with around 120 pieces from his most creative period, from 1880 to the mid-1890s. The first room is lined with early, representational paintings: wintry street scenes, fruity still lives and some dark domestic portraits of family members. These are skilful works with impressionistic brush-strokes and rich impasto. Manet's influence is palpable, as is Rembrandt's. Yet only one canvas feels truly fresh. Painted in 1883, "The Scandalised Masks" is a domestic scene of sorts, in which a sorry-looking hunch of a man is startled from his drinking by an old woman at the door. They are both wearing masks: hers has cavernous eyeholes and a protuberant nose, while his has a long, sad nose. The effect is weirdly mesmerising. It is for good reason that this painting is the first to greet visitors when they enter the show.

Masks that both disguise and reveal became one of Ensor's obsessions, along with experiments with light, images of death and carnivalesque approaches to religious subjects. Ms Swinbourne has managed to secure the first two enormous works from his Aureoles drawing series of 1885-86, which have never

been seen before in America. They are remarkable, particularly the seven-foot (2.1-metre) “The Lively and Radiant: The Entry of Christ into Jerusalem”. Vast and detailed, it not only absorbs viewers, but virtually swallows them whole. Gazing at the vibrating and bizarre faces within the drawing, Ms Swinbourne remarks: “Even if I have failed at everything else in this show, at least I brought these here.”

Ensor’s artistic leap into unreality is next. Isolated from his modernist peers in France and Germany (and often resentful of them), he managed to create a dreamy visual language all his own. Ensor’s vivid critiques of Belgian culture are playfully subversive and scatologically immature. His more nightmarish paintings, such as his 1891 work, “Skeletons Fighting Over a Pickled Herring” (pictured below), are strangely unsettling. Only one picture is notable for its absence: “Christ’s Entry into Brussels in 1889”, Ensor’s mural-sized burlesque masterpiece, which the Getty Museum refused to loan for this show.

Ensor was not his own best ambassador. He was paranoid, self-obsessed and misanthropic. He chafed at criticism and compared himself to Jesus; his journals would try any reader’s patience. When he died in 1949, aged 89, he had not produced a work of note for decades. But the real hindrance to placing Ensor has always been his imagination—the way he worked beyond ordinary “isms”. This show, by revealing the extent of his quirky ingenuity, promises to generate a level of attention he hasn’t had for years.

Michael Jackson

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Michael Jackson, pop star, died on June 25th, aged 50

Getty Images



FIRST, the songs. The light, infectious lilt of "Don't Stop Til You Get Enough". The sheer, vicious swoop of "Speed Demon". The soft, syncopated sadness of "Billie Jean", or the raucous shouts of "Bad". His high, pure tenor was shot through with the little yips and sighs he had learnt from Diana Ross. And behind it lay the astonishing confidence of child-star Michael in "I'll Be There" or "Rockin' Robin", with each note treble-true and each time-change as natural as taking breath.

Next, the dancing, springing from the music like a bird out of a trap. Pointing, jerking, thrusting, with rage in his feet, as Fred Astaire said once. He was at war with the floor as it slid away in the Moonwalk, and with the air as he spun through it. He danced with his knees, on tiptoe, hunching his shoulders to his ears. His splayed hand pulled at his crotch as if emasculation would be sweet to him.

The show was everything. Lights made a giant of him as he stood motionless: one white, glittering, gloved hand raised, fedora pulled down at a slant. Under the tight, too-short trousers, sequinned socks ("No one would recognise Bruce Springsteen by his socks"). On stage he felt truly alive, invincible, "unlimited". He would appear in explosions of smoke and fire, or fly away like an astronaut. On his videos he was a leader of crowds, prowling the city in "Thriller" (1983) in an outfit red as blood. P.T. Barnum was his model, crossed with Walt Disney. He wanted his life to be "the greatest show on earth". And so, for much of the 1980s and 1990s, it was, with "Thriller" the biggest-selling album ever, eight Grammys in 1983, his dark, lavish videos a staple of the fledgling MTV channel and his place as the King of Pop assured.

In Neverland

What lay behind it? He told his biographer, Randy Taraborrelli, that he had "deep, dark secrets". They were encased in a voice as soft as a whisper, a handshake that felt like a cloud, a face as pale and delicate as plastic surgery and Porcelana skin-bleach could make it. Dark glasses and surgical masks kept the world away from him. On his estate at Neverland in southern California, remote from the "normal people" who might grab and scratch him, he lived like a child with blank-eyed mannequins, pet snakes

and Ferris wheels. He shared his meals with a chimpanzee and his bed with young boys, "the most loving thing to do". People spread rumours about him, even twice accused him of sexual abuse, but he was never proved guilty of anything: except love, and desire for lost childhood, and a longing to be Peter Pan.

But that too was a show. Behind it was a man who could not bear to hear that Elvis still surpassed him, or that Madonna had won a Grammy when he hadn't. He could force hard deals and millions of dollars out of Motown, CBS and Sony in face-to-face confrontations; he could fire his manager and his lawyer, after years of service, without a trace of sentiment, for letting down the brand; he could beat Paul McCartney to the Beatles' back catalogue and exploit it ruthlessly, despite their friendship. He performed for 18 years with his four elder brothers in the Jackson 5, the bouncing, grinning child from Gary, Indiana transforming into a global megastar, then left them as brutally as he had always upstaged them. But the family never left him. He blanked Joseph Jackson from his life and excised him from his face, but could not forget his father's exhortation to be "a winner, not a loser". Perfectionism, like distrust, had been beaten into him.

What show business required, he had also learnt, was to give the fans what they wanted. If they demanded fantasies, he would provide them. ("The longer it takes them to discover [who I am], the more famous I will be.") From the end of the 1980s he devised ever more headline-grabbing ventures: bidding for the bones of the Elephant Man, sleeping in an oxygen chamber, appearing in toyshops and galleries in garish wigs and moustaches. Dates were arranged with Tatum O'Neal and Brooke Shields to prove he was all man, rather than the shrinking virgin of his other public self. Two marriages were undertaken, three children vicariously produced.

Oddness overshadowed his real, hard-won achievements: world adulation for a black pop star, the birth of video celebrity, and millions of dollars given to black causes. If the press stayed on his weird story, he believed, his records would sell. The risk was that the weirdness would multiply until he was hardly human.

His last public appearance, before his death of apparent cardiac arrest, was to announce a series of 50 sold-out concerts in London. Hours before his death he was rehearsing for them, exuding joy, energy and sharp judgment. His glitter jackets, the tabloids claimed later, hid a body that was half-starved, subsisting on painkillers. Though he was worth $1.3 billion, said the *Sun*, he died with debts of $300m.

But he had sold 750m albums and, from Riga to Rio, children danced like him. In the words of his "Dirty Diana",

That's OK
Hey baby do what you want
I'll be your night lovin' thing
I'll be the freak you can taunt
And I don't care what you say
I want to go too far
I'll be your everything
If you make me a star

Overview

Jul 2nd 2009
From The Economist print edition

The unemployment rate in **Japan** rose to 5.2% in May from 5% in April. Industrial production jumped by 5.9% in May, after a similar rise in April. Big manufacturing firms were less gloomy in June than they had been in March, according to the Bank of Japan's quarterly Tankan survey. The percentage balance of firms reporting "favourable" over "unfavourable" conditions rose to minus 48 from a record low of minus 58.

In **America** the Institute for Supply Management's manufacturing index rose for the sixth month in a row, to 44.8. Readings below 50 point to shrinking activity but the pace of contraction is at least slowing. Consumer confidence faltered in June after rising in each of the previous three months, according to the index published by the Conference Board, a business-research firm.

Britain's GDP fell by 2.4% in the first quarter of 2009, revised from an earlier estimate of a 1.9% decline. That left it 4.9% lower than a year earlier, the largest such fall on record. Britain's current-account deficit narrowed to £8.5 billion ($12.2 billion), or 2.5% of GDP, in the first quarter from £8.8 billion in the three months to December.

Consumer prices in the **euro area** fell for the first time ever in the year to June. The unemployment rate in the currency zone rose to 9.5% in May. In **Ireland** GDP fell by 1.5% in the first quarter, leaving it 8.5% lower than in the same period in 2008.

Sweden's central bank cut its main interest rate from 0.5% to 0.25% on July 2nd.

Output, prices and jobs

Jul 2nd 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−2.5 Q1	−5.5	−2.8	+1.6	−13.4 May	−1.3 May	+4.2	−0.8	9.4 May
Japan	−8.8 Q1	−14.2	−6.7	+0.8	−29.5 May	−1.1 May	+1.3	−1.1	5.2 May
China	+6.1 Q1	na	+6.5	+7.3	+8.9 May	−1.4 May	+7.7	−0.5	9.0 2008
Britain	−4.9 Q1	−9.3	−3.7	+0.6	−12.3 Apr	+2.2 May§	+3.3	+1.5	7.2 Apr††
Canada	−2.1 Q1	−5.4	−2.3	+1.7	−9.9 Apr	+0.1 May	+2.2	+0.3	8.4 May
Euro area	−4.8 Q1	−9.7	−4.1	+0.5	−21.6 Apr	−0.1 Jun	+4.0	+0.4	9.2 Apr
Austria	−3.5 Q1	−10.6	−2.6	+0.2	−10.9 Apr	+0.3 May	+3.7	+0.5	4.2 Apr
Belgium	−3.0 Q1	−6.2	−3.3	+0.2	−11.5 Mar	−1.1 Jun	+5.8	+0.5	11.0 May‡‡
France	−3.2 Q1	−4.8	−2.8	+0.5	−18.8 Apr	−0.3 May	+3.3	+0.2	8.9 Apr
Germany	−6.9 Q1	−14.4	−5.5	+0.5	−21.6 Apr	−0.3 Jun	+3.3	+0.2	8.3 Jun
Greece	+0.3 Q1	−4.6	−3.0	−0.9	−11.7 Apr	+0.5 May	+4.9	+0.4	9.2 Mar
Italy	−6.0 Q1	−10.1	−4.4	+0.3	−24.2 Apr	+0.5 Jun	+3.8	+0.7	7.3 Q1
Netherlands	−4.5 Q1	−10.7	−3.9	+0.5	−13.2 Apr	+1.6 May	+2.3	+0.9	4.5 May††
Spain	−3.0 Q1	−7.4	−3.5	−0.5	−28.6 Apr	−0.9 May	+4.6	−0.1	18.1 Apr
Czech Republic	−3.4 Q1	−12.9	−3.0	+1.2	−21.7 May	+1.3 May	+6.8	+1.9	7.9 May
Denmark	−4.1 Q1	−4.2	−3.5	+0.5	−15.0 Apr†††	+1.3 May	+3.4	+1.0	3.5 May
Hungary	−6.7 Q1	−9.6	−6.0	−1.0	−25.3 Apr	+3.8 May	+7.0	+3.3	9.8 May††
Norway	+1.5 Q1	−1.8	−2.0	+0.5	−4.0 Apr	+3.0 May	+3.1	+2.0	3.1 Apr***
Poland	+0.8 Q1	na	−0.8	+1.5	−5.2 May	+3.6 May	+4.4	+2.5	10.8 May‡‡
Russia	−9.5 Q1	na	−5.0	+2.0	−17.1 May	+12.3 May	+15.1	+12.1	9.9 May‡‡
Sweden	−6.5 Q1	−3.6	−4.6	+0.9	−21.2 Apr	−0.4 May	+4.0	−0.4	9.0 May‡‡
Switzerland	−2.4 Q1	−16.0	−2.3	+0.3	−9.4 Q1	−1.0 May	+2.9	−0.5	3.5 May
Turkey	−13.8 Q1	na	−4.5	+1.2	−18.5 Apr	+5.2 May	+10.7	+6.2	16.1 Q1‡‡
Australia	+0.4 Q1	+1.5	−0.8	+1.6	−0.7 Q4	+2.5 Q1	+4.2	+1.8	5.7 May
Hong Kong	−7.8 Q1	−16.1	−6.7	+0.9	−10.2 Q1	+0.1 May	+5.6	+1.0	5.3 May††
India	+5.8 Q1	na	+5.5	+6.4	+1.4 Apr	+8.7 Apr	+7.8	+5.2	6.8 2008
Indonesia	+4.4 Q1	na	+2.4	+3.1	+1.5 Apr	+3.8 May	+10.4	+4.2	8.4 Aug
Malaysia	−6.2 Q1	na	−3.0	+1.2	−11.5 Apr	+2.4 May	+3.8	−0.4	3.0 Q4
Pakistan	+5.8 2008**	na	+1.3	+2.3	−20.6 Mar	+14.4 May	+19.3	+12.0	5.6 2007
Singapore	−10.1 Q1	−14.6	−8.6	+1.3	+2.0 May	−0.3 May	+7.5	−0.2	3.3 Q1
South Korea	−4.2 Q1	+0.5	−5.0	+0.6	−9.0 May	+2.0 Jun	+5.5	+1.6	3.9 May
Taiwan	−10.2 Q1	na	−6.9	+0.5	−18.2 May	−0.1 May	+3.7	−1.3	5.8 May
Thailand	−7.1 Q1	−7.3	−4.5	+1.9	−9.7 Apr	−3.3 May	+7.6	−1.0	2.1 Apr
Argentina	+2.0 Q1	+0.2	−3.5	+0.5	−1.2 Apr	+5.5 May	+9.1	+7.0	8.4 Q1‡‡
Brazil	−1.8 Q1	−3.3	−1.5	+2.7	−14.8 Apr	+5.2 May	+5.6	+4.7	8.8 May‡‡
Chile	−2.1 Q1	−2.4	−1.0	+2.0	−10.5 May	+3.0 May	+8.9	+2.4	9.8 Apr††‡‡
Colombia	−0.6 Q1	+0.9	−1.2	+2.5	−14.5 Apr	+4.8 May	+6.4	+5.0	12.1 Apr‡‡
Mexico	−8.2 Q1	−21.5	−7.1	+2.8	−13.2 Apr	+6.0 May	+4.9	+5.5	5.3 May‡‡
Venezuela	+0.3 Q1	na	−4.1	−2.7	−0.9 Jan	+27.7 May	+31.4	+30.2	8.1 Q1‡‡
Egypt	+4.3 Q1	na	+4.0	+3.8	+5.7 Q4	+10.2 May	+19.7	+9.7	9.4 Q1‡‡
Israel	+0.5 Q1	−3.6	−1.0	+1.6	−7.7 Mar	+2.8 May	+5.4	+2.7	7.6 Q1
Saudi Arabia	+4.2 2008	na	−1.0	+3.1	na	+5.5 May	+10.4	+4.3	na
South Africa	−1.3 Q1	−6.4	−2.2	+3.1	+8.4 Apr	+8.0 May	+11.7	+6.6	23.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−15.1 Q1	na	−13.0	−3.0	−30.0 May	−0.3 May	+11.3	nil	13.9 Apr
Finland	−7.6 Q1	−10.3	−5.6	−0.1	−21.0 Apr	nil May	+4.2	+0.3	8.6 May
Iceland	−3.9 Q1	−13.6	−12.1	−0.7	+10.1 2008	+12.2 Jun	+12.7	+12.5	8.7 May‡‡
Ireland	−8.5 Q1	−5.7	−7.5	−2.8	−6.7 Mar	−4.7 May	+4.7	−3.5	11.8 May
Latvia	−18.0 Q1	na	−17.0	−4.0	−16.9 Apr	+4.7 May	+17.9	+2.5	17.4 Apr
Lithuania	−13.6 Q1	−35.8	−13.0	−4.5	−25.5 Apr	+5.2 May	+12.0	+5.0	8.7 Apr‡‡
Luxembourg	−5.2 Q4	−16.8	−5.0	−0.9	−38.9 Mar	−0.3 May	+4.0	+0.5	5.5 Apr‡‡
New Zealand	−2.2 Q1	−2.7	−2.7	+0.6	−7.2 Q4	+3.0 Q1	+3.4	+1.4	5.0 Q1
Peru	+3.0 Mar	na	+1.3	+2.6	−13.6 Apr	+3.1 Jun	+5.7	+3.8	8.5 May‡‡
Philippines	+0.4 Q1	−8.9	−1.8	+2.3	−12.7 Mar	+3.3 May	+9.5	+2.9	7.5 Q2‡‡
Portugal	−3.7 Q1	−6.2	−4.1	−0.3	−9.9 Apr	−1.2 May	+2.8	−0.7	8.9 Q1‡‡
Slovakia	−5.6 Q1	na	−4.0	+0.7	−24.8 Apr	+2.2 May	+4.6	+1.5	11.4 May‡‡
Slovenia	−8.5 Q1	na	−4.0	+0.5	−24.9 Apr	+0.3 Jun	+7.0	+1.2	8.8 Apr‡‡
Ukraine	+6.9 Q3	na	−12.0	+1.0	−31.8 May	+14.7 May	+31.1	+16.0	2.6 May
Vietnam	+4.5 Q2	na	+2.1	+4.9	+5.4 Apr	+3.9 May	+25.2	+6.0	4.6 2007

*% change on previous quarter, annual rate. †The Economist poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate −1.1 in May. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Jul 2nd 2009
From The Economist print edition

The Economist commodity-price index

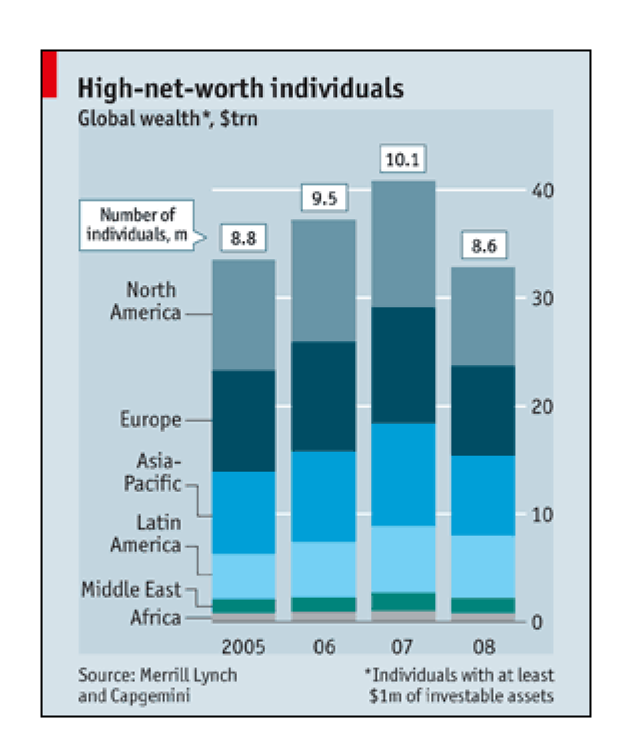
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	Jun 23rd	Jun 30th*	% change on one month	% change on one year
Dollar index				
All items	181.6	183.0	-4.6	-32.8
Food	204.1	203.4	-7.6	-27.5
Industrials				
All	152.5	156.5	+0.9	-40.1
Nfa†	126.2	121.8	-9.6	-41.2
Metals	166.8	175.5	+5.6	-39.7
Sterling index				
All items	168.8	168.5	-4.0	-18.7
Euro index				
All items	119.9	120.6	-2.7	-24.5
Gold				
$ per oz	922.50	938.05	-4.5	-0.5
West Texas Intermediate				
$ per barrel	68.82	69.97	+1.8	-50.5

*Provisional †Non-food agriculturals.

High-net-worth individuals

Jul 2nd 2009
From The Economist print edition



The wealth of the world’s high-net-worth individuals (HNWIs) fell by almost a fifth last year to $33 trillion, according to the 2009 World Wealth Report from Merrill Lynch and Capgemini. A HNWI has at least $1m of assets besides his main home, its contents and collectable items. In 2008 the number of HNWIs went down to 8.6m, just over 0.1% of the world’s population. Their wealth declined by more than 20% in North America, Europe and Asia, but by a bit less in Africa and the Middle East. Latin America’s rich were the least affected: they lost 6% of their wealth, and the number of HNWIs there fell by less than 1%. In North America, which had a large proportion of people just above the $1m threshold, the ranks slimmed by 19%.



Trade, exchange rates, budget balances and interest rates

Jul 2nd 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ Jul 1st	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−711.0 Apr	−628.3 Q1	−3.2	–	–	−13.2	0.34	3.54
Japan	+6.0 Apr	+111.1 Apr	+1.7	96.7	106	−6.8	0.43	1.35
China	+293.9 May	+426.1 Q4	+7.4	6.83	6.85	−3.8	1.32	3.42
Britain	−150.6 Apr	−52.5 Q1	−1.6	0.61	0.50	−13.9	1.20	3.76
Canada	+28.0 Apr	−3.9 Q1	−1.9	1.15	1.02	−2.1	0.23	3.47
Euro area	−54.7 Apr	−146.2 Apr	−1.0	0.71	0.63	−5.9	1.09	3.40
Austria	−4.2 Mar	+15.0 Q4	+1.7	0.71	0.63	−4.6	1.09	4.14
Belgium	+5.0 Mar	−12.0 Mar	−1.8	0.71	0.63	−4.8	1.10	3.97
France	−78.6 Apr	−63.5 Apr	−2.2	0.71	0.63	−6.6	1.09	3.75
Germany	+205.8 Apr	+178.3 Apr	+4.4	0.71	0.63	−4.6	1.09	3.40
Greece	−58.8 Mar	−45.2 Apr	−8.8	0.71	0.63	−6.5	1.09	5.03
Italy	−13.7 Apr	−69.6 Apr	−2.6	0.71	0.63	−5.2	1.09	4.42
Netherlands	+44.8 Apr	+50.0 Q1	+5.9	0.71	0.63	−4.1	1.09	3.82
Spain	−109.3 Apr	−135.9 Mar	−7.5	0.71	0.63	−9.6	1.09	4.06
Czech Republic	+4.1 Apr	−6.3 Apr	−2.0	18.2	15.0	−4.0	2.10	5.75
Denmark	+6.7 Apr	+7.5 Apr	+1.0	5.27	4.70	−2.5	1.48	3.82
Hungary	+0.6 Apr	−11.3 Q1	−2.9	191	149	−3.9	9.66	10.01
Norway	+65.1 May	+79.6 Q1	+12.5	6.35	5.07	7.2	1.94	4.12
Poland	−18.2 Apr	−19.3 Apr	−5.7	3.09	2.11	−4.0	4.43	6.22
Russia	+132.5 May	+75.4 Q1	+0.9	31.1	23.4	−8.0	11.50	10.58
Sweden	+12.8 May	+31.4 Q1	+7.3	7.58	5.97	−4.7	0.28	3.47
Switzerland	+17.9 May	+56.6 Q1	+7.6	1.08	1.02	−3.1	0.40	2.29
Turkey	−51.0 May	−26.7 Apr	−0.7	1.52	1.24	−5.6	10.22	6.64‡
Australia	+6.6 May	−29.8 Q1	−4.7	1.24	1.04	−4.2	3.16	5.50
Hong Kong	−21.7 May	+29.3 Q1	+7.7	7.75	7.80	−4.1	0.36	2.49
India	−96.4 May	−29.8 Q1	−1.7	47.9	43.2	−7.7	3.31	7.57
Indonesia	+10.4 May	−0.8 Q1	+0.9	10,190	9,215	−3.0	7.51	7.64‡
Malaysia	+41.7 Apr	+40.5 Q1	+12.3	3.52	3.27	−7.8	2.13	2.68‡
Pakistan	−17.0 May	−15.3 Q4	−2.1	81.5	69.2	−5.0	12.77	14.58†
Singapore	+17.0 May	+23.1 Q1	+14.9	1.44	1.36	−4.1	0.50	2.38
South Korea	+15.2 Jun	+13.2 Apr	+2.9	1,268	1,037	−5.7	2.41	4.98
Taiwan	+12.3 May	+29.2 Q1	+9.6	32.8	30.4	−5.2	0.85	1.45
Thailand	+10.6 May	+8.3 May	+5.3	34.1	33.4	−5.6	1.40	3.27
Argentina	+15.8 May	+6.8 Q1	+2.0	3.80	3.02	−1.2	14.63	na
Brazil	+27.5 Jun	−20.7 May	−1.3	1.93	1.60	−2.0	9.16	6.16‡
Chile	+4.0 May	−4.3 Q1	−1.4	534	516	−3.3	1.32	2.80‡
Colombia	+0.1 Mar	−6.5 Q1	−3.7	2,121	1,831	−3.4	5.54	6.00‡
Mexico	−15.5 May	−14.2 Q1	−3.5	13.1	10.4	−5.4	4.72	8.05
Venezuela	+32.5 Q1	+26.2 Q1	+1.1	6.53	3.45§	−4.7	14.54	6.55‡
Egypt	−26.8 Q4	−2.9 Q1	−1.5	5.59	5.33	−7.1	10.16	3.23‡
Israel	−10.2 May	+4.1 Q1	+1.7	3.86	3.27	−6.2	0.33	3.96
Saudi Arabia	+197.4 2008	+124.0 2008	−2.1	3.75	3.75	−5.1	0.65	na
South Africa	−5.8 May	−18.7 Q1	−5.8	7.74	7.82	−4.1	7.50	9.13
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−2.7 Apr	−1.0 Apr	−3.3	11.1	9.86	−3.7	6.32	na
Finland	+6.7 Apr	+3.4 Apr	+0.8	0.71	0.63	−2.6	1.03	3.83
Iceland	+0.3 May	−6.1 Q1	+3.6	127	78.1	−12.0	7.88	na
Ireland	+47.6 Apr	−11.3 Q1	−2.2	0.71	0.63	−12.6	1.09	5.59
Latvia	−4.6 Apr	−2.3 Apr	−2.0	0.50	0.44	−8.0	17.03	na
Lithuania	−4.8 Apr	−3.0 Apr	−1.8	2.44	2.18	−4.8	8.56	na
Luxembourg	−7.5 Mar	+3.0 Q4	na	0.71	0.63	−3.7	1.09	na
New Zealand	−2.2 May	−11.8 Q1	−6.1	1.56	1.31	−6.7	3.80	5.91
Peru	+1.8 Apr	−3.8 Q1	−2.9	3.00	2.95	−2.3	3.10	na
Philippines	−6.9 Apr	+5.1 Mar	+2.7	48.1	45.2	−2.9	3.94	na
Portugal	−31.6 Mar	−25.8 Apr	−9.9	0.71	0.63	−6.0	1.09	4.38
Slovakia	−0.1 Apr	−5.7 Apr	−7.0	21.3	19.1	−5.1	1.35	4.41
Slovenia	−3.8 Apr	−2.4 Mar	−2.5	0.71	0.63	−4.7	1.09	na
Ukraine	−13.4 Q1	−10.1 Q1	−0.3	7.74	4.62	−4.3	9.66	na
Vietnam	−5.0 Jun	−7.0 2007	−10.2	17,801	16,844	−8.8	8.01	7.07

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

Jul 2nd 2009
From The Economist print edition

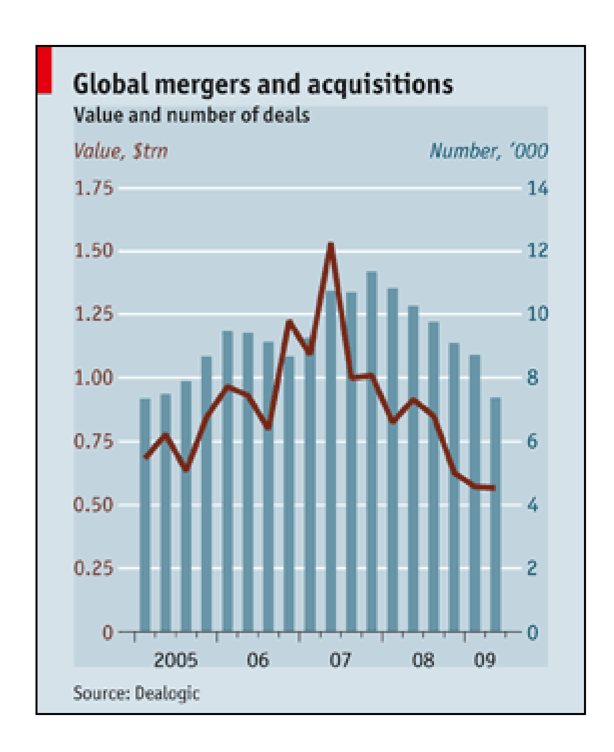
Markets

	Index Jul 1st	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	8,504.1	+2.5	-3.1	-3.1
United States (S&P 500)	923.3	+2.5	+2.2	+2.2
United States (NAScomp)	1,845.7	+3.0	+17.0	+17.0
Japan (Nikkei 225)	9,939.9	+3.6	+12.2	+5.2
Japan (Topix)	928.3	+2.9	+8.0	+1.3
China (SSEA)	3,157.8	+2.9	+65.2	+64.9
China (SSEB, $ terms)	193.9	+5.1	+75.1	+74.9
Britain (FTSE 100)	4,340.7	+1.4	-2.1	+12.2
Canada (S&P TSX)	10,374.9	+2.7	+15.4	+24.1
Euro area (FTSE Euro 100)	757.1	+1.7	+1.4	+3.1
Euro area (DJ STOXX 50)	2,449.7	+1.3	+0.1	+1.7
Austria (ATX)	2,139.7	+4.9	+22.2	+24.2
Belgium (Bel 20)	2,074.0	+2.9	+8.7	+10.5
France (CAC 40)	3,217.0	+1.0	nil	+1.6
Germany (DAX)*	4,905.4	+1.4	+2.0	+3.7
Greece (Athex Comp)	2,237.0	+1.7	+25.2	+27.3
Italy (S&P/MIB)	19,443.2	+2.1	-0.1	+1.6
Netherlands (AEX)	260.3	+2.2	+5.8	+7.6
Spain (Madrid SE)	1,029.0	+3.1	+5.4	+7.2
Czech Republic (PX)	899.0	-0.6	+4.8	+11.2
Denmark (OMXCB)	275.4	+2.2	+21.7	+23.7
Hungary (BUX)	15,426.0	+1.4	+26.0	+26.4
Norway (OSEAX)	338.3	+2.8	+25.2	+38.1
Poland (WIG)	30,688.7	+1.3	+12.7	+8.0
Russia (RTS, $ terms)	977.9	+2.0	+57.5	+54.8
Sweden (OMXS30)†	813.7	+3.9	+22.9	+28.2
Switzerland (SMI)	5,472.9	+0.5	-1.1	-2.4
Turkey (ISE)	37,245.9	+4.2	+38.6	+40.4
Australia (All Ord.)	3,872.3	+1.8	+5.8	+21.3
Hong Kong (Hang Seng)	18,378.7	+2.7	+27.7	+27.7
India (BSE)	14,645.5	+1.5	+51.8	+54.4
Indonesia (JSX)	2,059.9	+3.2	+52.0	+62.6
Malaysia (KLSE)	1,079.4	+2.0	+23.1	+21.0
Pakistan (KSE)	7,174.5	+2.1	+22.3	+18.8
Singapore (STI)	2,352.6	+3.2	+33.5	+33.3
South Korea (KOSPI)	1,411.7	+3.5	+25.5	+24.7
Taiwan (TWI)	6,579.0	+3.1	+43.3	+43.5
Thailand (SET)	597.5	+2.8	+32.8	+35.6
Argentina (MERV)	1,610.1	+4.2	+49.1	+35.6
Brazil (BVSP)	51,543.0	+3.8	+37.3	+65.8
Chile (IGPA)	14,822.1	+2.1	+30.9	+56.1
Colombia (IGBC)	10,024.5	+3.3	+32.6	+40.6
Mexico (IPC)	24,524.0	+3.4	+9.6	+15.9
Venezuela (IBC)	44,508.4	+2.7	+26.8	+36.6
Egypt (Case 30)	5,702.9	+2.1	+24.1	+22.2
Israel (TA-100)	811.9	+1.8	+43.9	+40.9
Saudi Arabia (Tadawul)	5,596.5	-0.2	+16.5	+16.6
South Africa (JSE AS)	22,710.2	+1.4	+5.6	+26.1
Europe (FTSEurofirst 300)	865.7	+1.4	+4.0	+5.8
World, dev'd (MSCI)	972.9	+2.3	+5.7	+5.7
Emerging markets (MSCI)	773.1	+4.2	+36.3	+36.3
World, all (MSCI)	247.3	+2.5	+8.6	+8.6
World bonds (Citigroup)	799.8	+0.4	-1.3	-1.3
EMBI+ (JPMorgan)	442.6	+1.8	+13.0	+13.0
Hedge funds (HFRX)§	1,076.9	+0.2	+5.5	+5.5
Volatility, US (VIX)	26.2	29.1	40.0	(levels)
CDSs, Eur (iTRAXX)‡	125.5	-11.4	-37.9	-36.9
CDSs, N Am (CDX)‡	186.1	-5.9	-20.3	-20.3
Carbon trading (EU ETS) €	13.3	-0.4	-17.8	-16.4

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §Jun 30th

Global mergers and acquisitions

Jul 2nd 2009
From The Economist print edition



The value of global mergers and acquisitions (M&A) fell by 35% in the first half of 2009 to $1,140 billion, according to Dealogic, a financial-analysis firm. The number of deals had been steadily shrinking, but they collapsed by more than 15% in the three months to June. Buy-outs by private-equity firms have been hit particularly hard by the recession. Their value fell by 82% to $24 billion in the six months to June. Australia, the most important location for M&A after America and Britain, saw a big increase in activity in the first half. So did the Netherlands and South Africa. Finance remains the richest industry for M&A, accounting for almost a fifth of deals by value, followed by health care and mining.